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APPENDICES

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CHAPTER 1: INTRODUCTION

SECTION 1: INTRODUCTION TO THE PROJECT SERVICING HANDBOOK

1.1 ABOUT THIS HANDBOOK

This handbook provides Loan Servicers with guidance about the Agency's procedures for servicing actions involving borrowers receiving loans or grants for Multi-Family Housing projects. Its goal is to help Loan Servicers in Field Offices perform consistent, effective servicing of projects financed by the Agency to ensure that they are operated in accordance with applicable regulatory and administrative requirements.

This handbook presents the Agency's project servicing procedures for:

- Section 515 Multi-Family Housing projects:
  - ◊ Rural rental housing (including congregate housing and group homes); and
  - ◊ Rural cooperative housing.
- Section 514/516 Farm Labor Housing projects:
  - ◊ Off-farm labor housing; and
  - ◊ On-farm labor housing.

The guidance provided by this handbook is intended to be consistent with all applicable laws, Executive Orders, and departmental regulations, including other Agency regulations. Nothing contained in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

1.2 COMPANION MULTI-FAMILY HOUSING HANDBOOKS

This handbook is the third in a series of three handbooks that describe the requirements and procedures for the Agency's Multi-Family Housing direct loan and grant programs. The two companion handbooks are:

- **HB-1-3560: Loan Origination.** This handbook covers the requirements and procedures for processing loan and grant applications for Multi-Family Housing projects, selecting projects for Agency funding, and closing the loans and grants for these projects.
- **HB-2-3560: Asset Management.** This handbook covers the requirements and procedures regarding the ongoing management of Multi-Family Housing projects and the Agency's oversight of borrower performance.

1.3 USING THIS HANDBOOK

The handbook is organized to allow the reader to look up information on specific topics easily. Several graphic tools and conventions have been used to make information easier to find and understand.

A. Citations and Text Boxes

- **Regulatory citations.** The regulation for Agency Multi-Family Housing programs is provided in 7 CFR Part 3560. The text of that regulation is included in **Appendix 1**. To help readers locate the regulatory authority for procedures described here, references to this regulation in paragraph headings appear in italicized brackets, for example: *[7 CFR 3560.51]*. Other regulations or RD Instructions are simply referenced.

- **Form references.** Agency forms and Agency guide, form, and system letters are shown in *italics.* All forms referenced in this handbook can be found in **Appendix 3** and all letters can be found in **Appendix 4**.

- **Examples and exhibits.** Text boxes labeled as examples provide a specific illustration of a concept described in the text. Exhibits illustrate key points and are numbered in sequence, using the chapter number and a sequence number; for example, Exhibit 3-1 is the first exhibit in Chapter 3.

B. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence using the chapter number and a sequence letter; for example, Attachment 4-A is the first attachment in Chapter 4.

- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters.

C. Terminology

Because terminology may vary from State to State and may change over time, this handbook uses certain standard terminology to provide consistency.

- **Agency.** The term “Agency” is used throughout this handbook to refer to the Rural Housing Service (RHS) within the U.S. Department of Agriculture (USDA) that is responsible for administration of the Multi-Family Housing programs.

- **Approval Official.** This term is used whenever someone other than the Loan Servicer must approve an action.

- **Borrower.** The term "borrower" refers to one or more individuals who are receiving Agency assistance through a Multi-Family Housing program in the form of a loan or a grant.

- **Field Office.** Because the number of offices and the nature of the work conducted in each office may vary from state to state, the term "Field Office" is used throughout this handbook to refer to the office that is originating or servicing the loan.

- **Loan Servicers.** This term refers to Field Office Staff with responsibility for ensuring that multi-family housing borrowers comply with program requirements and for servicing loan accounts.

- **Management Agent.** A "management agent" is an entity that contracts with the borrower to perform the management functions necessary to effectively operate a multi-family housing project.

- **State Director.** This term is used to refer to the Director of the State Office or the Agency staff person to whom the State Director has delegated decisionmaking authority for a specific aspect of the program. Unless otherwise specified, each State Director may determine which actions may be approved at the Field Office and which must be approved at the State Office.

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SECTION 2: OVERVIEW OF THE AGENCY'S MULTI-FAMILY HOUSING PROGRAMS

1.4 GOALS OF RHS MULTI-FAMILY HOUSING PROGRAMS

The purpose of the Agency's Multi-Family Housing programs is to provide adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. In providing this service, the Agency strives to meet several goals.

- **Customer service.** The Agency is committed to providing customer-friendly, streamlined service. The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders.

- **Partnerships.** The Agency seeks to enhance its ability to serve eligible households by working with its partners, such as borrowers, property management agents, tenants, other lenders, nonprofit organizations, and State and Local agencies.

- **Effective use of resources.** As publicly funded initiatives, the Agency's Multi-Family Housing programs must use tax dollars efficiently. The Agency aims to minimize administrative costs, underwrite loans responsibly, and leverage funding with private sources of credit to the extent possible.

1.5 SECTION 515 PROGRAM—OVERVIEW

The Section 515 direct loan program *[7 CFR Part 3560]* provides financing to support the development of rental units in rural areas that need housing affordable for very low-, low-, and moderate-income households, and where this housing is unlikely to be provided through other means.

Section 515 loans can be used to build, acquire and rehabilitate, or improve dwellings in rural areas. The term for loans is tied to the expected useful life of the property, and the standard term for an initial Section 515 loan is 30 years with a 50-year amortization period. However, the term for subsequent loans and loans for special types of properties, such as manufactured housing, may be made for a shorter term based on the project's expected useful life.

Each loan is made at a note rate established by the Agency as prescribed in RD Instruction 440.1. Borrowers approved for initial and/or subsequent loans receive interest credit that reduces the effective interest rate for the Agency's financing, thereby lowering the property's rents. In return for this below-market rate financing, the borrower agrees to lease the project's rental units to income-eligible households at rents approved by the Agency.

1.6 SECTION 514/516 PROGRAMS—OVERVIEW

Section 514/516 direct loan and grant programs provide funds to support the development of adequate, affordable housing for farmworkers that is unlikely to be provided through other means.

A. Section 514 Loans and Section 516 Grants for Off-Farm Housing

Section 514 loans and Section 516 grants can be used for the same purposes as Section 515 loans to finance rental housing for farmworkers. Unlike Section 515 projects, off-farm labor housing projects may be built outside rural areas, as long as the project addresses a need for affordable housing for farmworkers. These projects are eligible for financing at terms comparable to Section 515 loans, a grant to cover a significant share of the development cost, or a loan/grant combination finance package. Tenants not only must be income-eligible, but also receive priority based on the proportion of their income received from farmwork.

B. Section 514 Loans for On-Farm Housing

Section 514 loans can also be used to finance the development of adequate housing for farmworkers involved in a specific farm operation—on-farm labor housing project. These projects are treated as part of the farming operation, and the occupants may or may not pay rent.

Labor housing borrowers who are providing shelter for domestic farm housing that is restricted for use by eligible residents supporting the borrower's farming operation may choose to provide that housing to residents without imposing charges for rent or utilities or may choose to impose charges for rent, utilities, or rent and utilities subject to Agency approval. All other labor housing borrowers who are providing shelter in support of farming operations in the community at large are expected to operate the program in accordance with Agency regulations governing the approval of charges for rent, utilities, or rent and utilities subject to Agency approval.

SECTION 3: GENERAL PROGRAM REQUIREMENTS

1.7 CIVIL RIGHTS *[7 CFR 3560.2]*

The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders. The civil rights compliance requirements for the Agency are contained in RD Instruction 1901-E. Exhibit 1-1 lists the applicable Federal laws and Executive Orders and highlights their key aspects.

Exhibit 1-1

Major Civil Rights Laws Affecting the Multi-Family Housing Loan and Grant Programs

- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally assisted program on the basis of race, color, and national origin.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally assisted program on the basis of age.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by Executive Order 12259.** Prohibits discrimination in housing or residential property financing to any Federally assisted activity against individuals on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally assisted construction contracts in excess of $10,000. Provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.
- **Executive Order 12898**. Requires each Federal agency to make achieving environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

A. Nondiscrimination

The various civil rights laws prohibit the denial of loans, grants, services, and benefits provided under the Section 515 and 514/516 programs to any person on the basis of race, color, national origin, sex, religion, marital status, familial status, age, physical or mental disability, or source of income, or because the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act (15 U.S.C. 1601). Discrimination in employment practices also is prohibited. These same requirements also apply to program participants. Agency oversight of borrower compliance with civil rights laws is covered in Chapter 4 of HB-2-3560. Civil rights complaints filed by tenants are handled by the Agency in accordance with RD Instruction 2000-GGG.

Effective management and consistent procedures are good business practices that help ensure that all applicants are treated fairly. Poor program implementation, whether discrimination is intended, has possible civil rights consequences.

Key Civil Rights Issues for Project Servicing

- Access;
- Consistency and fairness of treatment;
- Disparate impacts, intended or unintended; and
- Record keeping.

B. Reasonable Accommodations for Persons with Disabilities

In addition to avoiding discrimination, the Agency and loan and grant recipients must make reasonable accommodations to permit persons with disabilities to apply for and benefit from Agency programs. Reasonable accommodations may include providing modifications to the dwellings and facilities so that they are physically accessible. Reasonable accommodations may also include effective communication and outreach tools so that all applicants can obtain program information (e.g., a Telecommunications Device for the Deaf [TDD]).

C. Limited English Proficiency *[7 CFR 3560.2]*

Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from Federally assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d, and Title VI regulations against national origin discrimination. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

D. Civil Rights Impact Analysis

Agency employees will conduct civil rights impact analyses in accordance with RD Instruction 2006-P, to determine whether proposed policy actions, if approved and implemented, will negatively and disproportionately affect employees, program

beneficiaries, or applicants for employment or program benefits due to race, national origin, or other protected basis.

1.8 REVIEWS AND APPEALS *[7 CFR 3560.9]*

Decisions that are not made in favor of a program participant (applicant or borrower) are known as adverse decisions. Adverse decisions must be based upon regulations that are published in the Code of Federal Regulations (CFR). For the direct Multi-Family Housing programs, any adverse decisions must be based upon 7 CFR Part 3560 and not the administrative guidance contained in this handbook. Adverse decisions include: (1) administrative actions taken by Agency officials, and (2) the Agency's failure to take required actions within timeframes specified in statutes or regulations, or within a reasonable time if no deadline is specified. **Appendix 2** of this handbook contains 7 CFR Part 11, which is the regulation of the National Appeals Division (NAD) and provides procedures that both Agency officials and program participants must follow when an appeal is made. *Handbook Letter 101 (3560), Standardized Adverse Decision Letter*, will be used for all adverse decisions unless another format is prescribed in this handbook.

A. Informing Program Participants of Their Rights

Whenever an Agency official makes a decision that will adversely affect a program participant, the official must inform the participant in writing that an informal review with the person who made the decision may be requested. If the decision is appealable, the participant will also be informed of their rights to seek mediation or Alternative Dispute Resolution (ADR) and to request a hearing with NAD; **Attachment 1-B** is used for this purpose. If the decision cannot be appealed, participants will be informed of their rights to have NAD review the accuracy of the Agency's finding that the decision cannot be appealed; **Attachment 1-C** is used for this purpose. Mediation or ADR rights are not provided on decisions that cannot be appealed. **Attachment 1-C** is used for this purpose.

Letters notifying participants of adverse decisions must contain the required information regarding an informal meeting, mediation or ADR, rights to NAD, and civil rights. **Attachment 1-A** includes only the specific civil rights language that must be contained in any adverse decision letter. **Attachments 1-B** through **1-I** contain, as necessary, the civil rights language and include information on requesting an informal review, mediation or ADR, and rights to NAD. The attachments are all titled to assist Field Office Staff in selecting the correct attachment for the decision being made. The attachments do not need to be used when a form, handbook letter, or other document already includes the appropriate participant rights.

B. Adverse Decisions That Cannot Be Appealed

Certain decisions made by the Agency cannot be appealed. In these cases, the participant is still provided the opportunity for an informal review; however, rights to an NAD appeal and rights to mediation or ADR are not offered. Participants will be informed through the use of **Attachment 1-C** that they may request an informal review

and write to NAD for a review of the accuracy of the Agency's determination that the case cannot be appealed. Decisions that cannot be appealed include:

- Decisions made by parties outside the Agency, even when these decisions are used as a basis for Agency decisions (such as when an applicant disagrees with a private lender's decision not to provide credit for a leveraged loan);

- An official's refusal to request an administrative waiver under the provisions of Paragraph 1.12 of this handbook, or a waiver authorized by any applicable regulation;

- Denials of credit due to lack of funds; and

- Rural area designations.

When one or more of the reasons for an adverse decision are reasons that cannot be appealed, the adverse decision cannot be appealed. In these cases, the letter containing the adverse decision will include only the items that cannot be appealed as the reason why the decision cannot be appealed. If other reasons also exist for the adverse decision, they will be listed separately in the decision letter as other reasons the assistance could not be granted.

C. Informal Review

Participants who want to request an informal review with the person who made the decision must do so within 15 days of the date of the Agency's letter notifying the participant of the adverse decision. The participant must make a request for an informal review in writing, and the request will be retained in the participant's case file. The informal review can be conducted, at the discretion of the Agency, by telephone or through a face-to-face meeting. The informal review can also be conducted by a representative of the person who made the decision. The purpose of the informal review is to further explain the Agency's reasons for the adverse decision, listen to why the participant feels the decision may be incorrect, and obtain any further information from the participant to support their request. The review must be completed within 45 days of the request, and the participant is notified in writing of the results. The State Director may require that the decision be reviewed by the next-level supervisor or other designated Rural Development Staff before the participant is notified of the decision. **Attachment 1-D** will be used if the adverse decision is not reversed as a result of the informal review. If the decision is reversed, a letter will be sent to the participant notifying them of the decision and next steps.

Participants may skip an informal review and, if applicable, request mediation or ADR, or an NAD appeal. In doing so, participants automatically waive their rights to an informal review.

D. Mediation or ADR

Adverse decisions that are appealable to NAD also require that the participant be given the opportunity to seek mediation or ADR prior to having a hearing with NAD. The

purpose of mediation or ADR is to resolve disputes through the use of a neutral mediator. State Directors may wish to consider issuing a State Supplement, outlining the coordination required between the Field Office and State Office on handling mediation and ADR requests.

Participants may skip mediation or ADR and request a NAD appeal. In doing so, they automatically waive their rights to mediation or ADR.

1. Requests for Mediation or ADR

After receiving **Attachment 1-B** or **1-D**, a program participant may request mediation or ADR services. Upon receipt of the program participant's request for mediation or ADR, **Attachment 1-E, 1-G**, or **1-H** is sent to the participant to start the process. The Attachments used depends upon whether the State in which the action applies is covered by a USDA-sponsored mediation program. These Attachments are generally sent by the State Director since costs are involved; however, they can be sent directly by the Field Office at the discretion of the State Director.

2. Cost of Mediation or ADR

There are generally costs associated with participation in mediation or ADR. When there are costs, they will be shared equally between the Agency and the program participant, if Agency funds are available. Where Agency funds are not available, the Agency will participate in mediation or ADR if requested by the program participant; however, the program participant will be notified in advance of the portion of the cost that the Agency will pay (if any) and their estimated cost for this service. The State Director will ensure that all participants requesting mediation or ADR in their State are treated consistently and pay the same percentage of the cost toward this service. The State Director may also consent to pay a larger percentage (up to 100 percent) of the cost of mediation or ADR for participants with incomes below the poverty level. The Agency will notify the mediation or ADR sources of how the cost of such service will be paid. **Attachments 1-E, 1-F, 1-G,** and **1-H** include language to meet this requirement.

3. Mediation in States with a USDA-Sponsored Mediation Program

Many States have a USDA-sponsored mediation program. These programs are funded, in part, by USDA and were established primarily to mediate cases originating from the Farm Service Agency (FSA). If program participants are unsure if a USDA-sponsored mediation program exists in their State, they should contact their State Director. In States with a USDA-sponsored mediation program, program participants who are provided appeal rights generally will be referred to the USDA-sponsored mediation program. ADR is not applicable in these States. **Attachment 1-E** may be sent to the program participant to acknowledge their request, and **Attachment 1-F** may be used to refer the case to the USDA-sponsored mediation program. In States where alternative mediation sources are readily available at a lower cost than the USDA-sponsored mediation program, the State will follow the guidance for States without a

USDA-sponsored mediation program, and include the USDA-sponsored mediation program on the list of acceptable providers.

4. Mediation or ADR in States without a USDA-Sponsored Mediation Program

In States without a USDA-sponsored mediation program, Agency officials are responsible for maintaining a list of mediators or ADR providers. The State Office will generally maintain this list as program participants are referred to the State Director to initiate mediation or ADR. FSA can generally provide a list of acceptable mediation or ADR sources in a State. Other contacts include the American Association of Arbitrators (AAA) or State bar association. When making contacts with these sources, the Agency must request the services of a mediator and not an arbitrator. (A mediator resolves disputes by negotiating a resolution through mutual agreement; an arbitrator resolves disputes through hearing both parties and then rendering a binding decision and should not be used.) The list of mediators will contain the approximate cost of each service provider, if known. States may handle the list of mediation and ADR sources as follows:

- The State may select a mediator or ADR provider from the list, provided there is not a significant variation in the cost of service providers. The list will be maintained alphabetically and sources selected in sequential order. **Attachment 1-G** may be sent to the program participant to acknowledge their request for mediation or ADR, and **Attachment 1-F** may be used to refer the case to the provider. States will need to maintain documentation to ensure that mediators and ADR providers receive and equal number of referrals. If there is a significant variation in cost among service providers, this option will not be used.

- The State may provide the list of mediators or ADR providers to the participant and request the participant to select the source or provide the name of another acceptable source of mediation or ADR. The list will contain the approximate cost of each service provider, if known. **Attachment 1-H** is used for this purpose and provides the participant with 10 days to select a service provider. After selection, **Attachment 1-F** will be used to refer the case to the mediator or ADR provider. If the program participant does not provide the name of a mediator or ADR provider within 10 days, their request for mediation or ADR will be considered withdrawn. Withdrawal or cancellation of mediation or ADR does not extinguish the participant's right to an appeal with NAD.

5. Timing of Mediation or ADR

Mediation or ADR must be completed within 45 days after the case is referred to the mediation or ADR source, unless the complexity of the case warrants a longer timeframe and all parties agree to a specific timeframe. A mediator or ADR provider will generally conduct a teleconference between the parties prior to accepting a case to determine if the case can be mediated. The Agency encourages the use of a pre-mediation conference since many adverse decisions in the Multi-Family Housing program may not lend themselves to mediation. Regardless, the Agency will not refuse to participate in mediation or ADR if requested to do so by the program participant.

Mediation or ADR occurs prior to having a hearing with NAD. Requests for mediation or ADR made prior to filing an appeal with NAD stop the clock on the 30-day period during which a participant may appeal to NAD. After mediation or ADR has concluded, any days that remain from the 30-day period are available to the participant to request an appeal to NAD. **Attachment 1-I** is used for this purpose. The person completing **Attachment 1-I** will need to determine the number of days the participant took to request mediation or ADR. Hearing dates for participants who request mediation or ADR after filing an appeal must be selected with 45 days of the conclusion of mediation or ADR. Participants may also request mediation or ADR after filing an appeal with NAD but prior to the hearing.

E. Appeal

Participants who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be signed by the participant and include: (1) a copy of the adverse decision to be appealed, and (2) a brief statement describing why the participant believes the decision is wrong.

Upon receiving a notice from NAD that an appeal has been filed, the Field Office will promptly provide NAD with a copy of the Agency record, specific references in 7 CFR Part 3560 to support the adverse decision, and any other pertinent information. A copy will also be provided to the program participant.

In accordance with NAD regulations, the program participant has the right to a face-to-face hearing in the participant's State of residence. The program participant also has the right to request that the hearing be handled by teleconference. An adverse decision made by the Agency may result in an appeal hearing and require a face-to-face hearing. In these cases, the Appeal Coordinator may request the State Director to provide Field Office Staff to attend the hearing and represent the Agency. The Appeals Coordinator will provide sufficient documentation and phone resources to the person selected by the State Director to adequately represent the Agency in the case.

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action that would have occurred had no adverse decision been made must be taken within 30 days after the effective date of the notice from NAD; unless the Agency requests a review of the case by the Director of NAD. See **Appendix 2** for more guidance on Director Reviews and other information regarding appeals.

1.9 CONFLICT OF INTEREST *[7 CFR 3560.10]*

All Agency employees must strive to maintain the highest levels of honesty, integrity, and impartiality in conducting their activities on behalf of the Agency. The Agency's conflict of interest requirements are described in RD Instruction 1900-D. To reduce the potential for conflicts of interest, all processing, approval, servicing, or review activity must be conducted by Agency employees who:

- Are not the recipient (applicant or borrower), a recipient's family member, or a close known relative of the recipient;

- Do not have an immediate working relationship with the recipient, the Agency employee related to the recipient, or the Agency employee who would normally conduct the activity; and

- Do not have a business or close personal association with the recipient.

A. Borrower Disclosure

Borrowers must disclose any known relationship or association with Agency employees.

B. Agency Employee Disclosure

Agency employees must disclose any known relationship or association with a borrower, regardless of whether the relationship is known to others.

C. Disposition of Real Estate Owned Properties

Agency employees and members of their families are precluded from purchasing real estate owned (REO) property, assumptions from Agency borrowers, or security property sold at a foreclosure sale. Closing agents and members of their families are precluded from purchasing properties in which they have been professionally involved.

1.10 OTHER FEDERAL REQUIREMENTS

A. Environmental Requirements *[7 CFR 3560.3 and 3560.4]*

The Agency considers environmental quality equally with economic, social, and other factors in its program development and decision making processes. Both Loan Originators and Loan Servicers are responsible for effectively integrating Agency environmental policies and procedures with servicing activities. It is particularly important for Loan Servicers to be aware of environmental requirements concerning sites, especially during the liquidation process, when the Agency needs to ensure that it will not acquire property with an environmental liability. Agency environmental policies and procedures and historic preservation requirements can be found in RD Instruction 1940-G. Agency-assisted properties also must meet the lead-based paint requirements contained in Exhibit H of RD Instruction 1924-A. Resolution of conflicts or significant differences between Agency environmental regulations and State or Local environmental laws requires prior consultation with National Office Environmental Staff.

B. Construction Standards

Sites and dwellings developed or rehabilitated with Section 515 or Section 514/516 funds must meet the construction standards outlined in RD Instructions 1924-A and 1924-C. Existing dwellings must be decent, safe, and sanitary and must meet all applicable State and Local codes. Certain state construction codes and requirements may influence RD Instructions 1924-A and 1924-C.

C. Lobby Restrictions

RD Instruction 1940-Q prohibits applicants and recipients of Agency assistance from using appropriated funds for lobbying the Federal Government in connection with a specific award. This instruction also requires that entities that request or receive loans or grants must disclose the expenditure of any funds, other than appropriated funds, for lobbying activities using Exhibit A-1 from RD Instruction 1940-Q.

D. Administrative Requirements

Agency employees must comply with Agency and departmental administrative requirements.

1. Procurement

Goods and services procured to support Agency activities such as appraisals, inspections, broker services, and property management services must conform with the policies and procedures of RD Instruction 2024-A.

2. File Management

Files and other Agency records must be maintained in accordance with RD Instruction 2033-A. Additional information is provided in Chapter 9 of HB-2-3560.

3. Handling Funds

Project funds must be handled in accordance with RD Instruction 1902-A.

1.11 EXCEPTION AUTHORITY *[7 CFR 3560.8]*

Exceptions to any requirement of this handbook or 7 CFR Part 3560 may be approved in individual cases by the Administrator if application of the requirement or failure to take action would adversely affect the Government's interest or conflict with the objectives and spirit of the authorizing statute. Any exception must be consistent with the authorizing statute and other applicable laws.

Requests for exceptions are submitted to the Administrator, through the Deputy Administrator, Multi-Family Housing, and may be initiated by the State Director; the Deputy Administrator, Multi-Family Housing; the Director, Multi-Family Housing Processing Division; or the Director, Multi-Family Housing Portfolio Management Division.

The exception request must provide clear and convincing evidence of the need for the exception. At a minimum the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the Government's interest;
- A discussion of proposed alternatives considered; and
- A discussion of how the adverse effects will be eliminated or minimized if the exception is granted.

Requests to the Administrator for exceptions regarding architectural and engineering, environmental, or civil rights issues will include the review and comments of the appropriate National Office Technical Staff.

ATTACHMENT 1-A

EQUAL CREDIT OPPORTUNITY ACT (ECOA)

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, martial status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this assistance is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-B

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT IS APPEALABLE

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe this decision or the facts used in this case are in error, you may pursue any or all of the following three options.

Option 1 - Informal Review

If you have questions concerning this decision or the facts used making it and desire further explanation, you may write this office to request an informal review. ***There is no cost for an informal review.*** This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review. You may skip this step in the informal process and select one of the following two options. If you do, you will automatically waive your right to an informal review.

Option 2 - Mediation or Alternative Dispute Resolution (ADR)

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need the information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to such service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 3). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 3.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 3 - Request an Appeal

You may request an appeal hearing by the NAD rather than an informal review, mediation, or ADR. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

Your request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 2.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, because of race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development (HUD). If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-C

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT CANNOT BE APPEALED

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving.

If you have questions concerning this decision or the facts used in making it and desire further explanation, you may write this office to request an informal review. This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review.

Applicants and borrowers generally have a right to appeal adverse decisions, but decisions based on certain reasons cannot be appealed. We have determined that reasons for the decision cannot be appealed under our regulations. You may, however, write the Assistant Director, NAD for a review of the accuracy of our finding that the decision cannot be appealed. Your request must be made no later than 30 days from the date you receive the attached letter.

NAD Assistant Director address:

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-D

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF UNFAVORABLE DECISION REACHED AS A RESULT OF AN INFORMAL REVIEW

We appreciated the opportunity to review the facts relative to your request for assistance. We regret that the decision in the attached letter did not grant the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe that facts used in this case are in error, you may pursue any or all of the following two options.

Option 1 - Mediation or Alternative Dispute Resolution (ADR)

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to this service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 2). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 2.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the National Appeals Division (NAD); however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 2 - Request an Appeal

You may request an appeal hearing by the National Appeals Division (NAD) rather than an informal review or mediation. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

The request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 1.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing, you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-E

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION IN STATES WITH A USDA-SPONSORED MEDIATION PROGRAM

This replies to your request for mediation or alternative dispute resolution services. The state in which you requested assistance has an impartial USDA-sponsored mediation program available. Your request for mediation has been sent to:

You will be contacted directly by the USDA-sponsored mediation program to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for mediation services. The cost estimated for this service is:

$ _____ You will be advised directly by the USDA-sponsored mediation program of the full cost of mediation. This is only an estimate and may vary depending on the issues and complexity of the case. If you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored program to cancel your request

Rural Development will:

_____ Contribute 50 percent towards the cost. The balance of the cast will have to be paid from your own resources.

_____ Cannot contribute towards the cost as the Agency does not have financial resources for these services. You must pay the full cost of mediation from your own personal resources.

_____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation is concluded, you will be notified of the results and the number of days remaining to request an appeal, if applicable. If you request mediation prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation.

Remember, if you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored mediation program to cancel your request. You will be responsible for any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-F

ATTACHMENT FOR REQUESTING MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) SERVICES

TO:

FROM:

SUBJECT: Request for Mediation or ADR Services

CUSTOMER:

The above-subject Rural Development customer has received an adverse decision from our Agency and has requested mediation or ADR services. Attached is a copy of the adverse decision letter and the customer's request for your service.

Informal Review:

___ The customer was provided with the opportunity for an informal review with the Agency; however, chose not to exercise this option.

___ An informal review was conducted; however, the Agency did not reverse its decision.

___ This case is under the jurisdiction of our State Office.

Payment for Service:

___ The customer and Agency will split the cost of this service 50/50.

___ The customer will pay the full cost of mediation or ADR.

___ The Agency will pay _____ towards mediation or ADR. The customer will pay the balance.

If the Agency is paying for any portion of the cost of this service, the bill for the Agency's portion should be submitted to this office. The customer is solely responsible for their portion of the cost of this service and should be bill directly.

Jurisdiction of case:

___ The adverse decision in this case was made by the following office. You should contact this office for further information on the case:

___ The adverse decision in this case was made by the ___[insert appropriate name]___. You may contact the Appeals Coordinator for further information on the case and to arrange for mediation or ADR:

USDA, Rural Development

Appeals Coordinator

ATTN: _____

_____, _____ _____

(___) ___-____, extension _____

Mediation or ADR must be completed within 45 days; unless the complexity of the case requires a longer time frame and all parties agree to a specific time frame. We also request a teleconference prior to your acceptance of this case to determine if the adverse decision lends itself to mediation or ADR.

ATTACHMENT 1-G

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF SERVICE PROVIDER

This replies to your request for mediation or alternative dispute resolution services. Your request has been sent to:

You will be contacted directly by the above to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

$ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

_____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.

_____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.

_____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office and the mediation or ADR provider to cancel your request. You will be responsible for

any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-H

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF POTENTIAL SERVICE PROVIDERS

This replies to your request for mediation or ADR services. Attached you will find a list of mediation and ADR providers. You will need to select one of the sources from the list, or you may provide the name of another independent mediation or ADR source. You must provide this office, in writing, with the name of the provider within 10 days. Rural Development will then contact the source and provide photocopies of the adverse decision letter and any other relevant information. We will also request that the mediation or ADR provider conduct a teleconference between the parties.

If we do not receive your selection of a mediator or ADR provider within 10 days, we will consider such inaction to be your notice to cancel your request for mediation or ADR. You may continue to pursue an appeal to the NAD as outlined in our original adverse decision letter.

As indicated in our original adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

> $ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office to cancel your request. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-I

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) DID NOT RESULT IN RESOLUTION OF ISSUES

We regret that we are unable to grant the assistance you requested or will terminate or reduce the assistance you requested. Mediation or ADR did not result in resolution of the issues.

If you believe the decision or facts used in the case are in error, you may pursue your right to an appeal by the NAD. ***There is no cost for an appeal.*** The number of days in which you have to request an appeal depends upon whether you previously requested an appeal to NAD prior to entering into mediation or ADR. ***Please follow the guidance in the paragraph indicated with an "X".***

___ You requested an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address to schedule the appeal hearing:

NAD Assistant Director address:

___ You did not request an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address. Your request must be postmarked within ____ days from receipt of this letter. This represents the difference between 30 days and the number of days you took after the adverse decision to request mediation or ADR. Use the NAD Assistant Director address is listed above.

Information regarding appeals

You have the right to an appeal hearing within 45 days of NAD's receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide, and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

cc: NAD Assistant Director

CHAPTER 2: MULTI-FAMILY HOUSING PROGRAMS AND LOAN SERVICING

2.1 INTRODUCTION

This chapter introduces key aspects of the Section 515 Rural Rental Housing and Section 514/516 Farm Labor Housing programs. Under these programs, the Agency provides direct loans and grants to support the development of affordable rental housing that serves rural areas. The Section 538 Multi-Family Housing Guarantee program—the Agency's third Multi-Family Housing program that guarantees loans made by private lenders—is covered in a separate regulation *[7 CFR Part 3565]* and HB-1-3565.

This chapter also describes the key project servicing procedures that the Agency uses to administer the terms of the Agency loan or grant agreement for the program. These procedures provide Loan Servicers with a consistent basis for conducting servicing actions and assisting borrowers in meeting their responsibilities.

Section 1 of this chapter introduces the types of loans and other forms of assistance available through the Section 515 program and the Agency's objectives in providing this assistance. Section 2 of this chapter describes the loans, grants, and other assistance available to increase the supply of affordable housing specifically targeted toward farm labor. The chapter concludes with Section 3, which introduces the major project servicing activities, as well as the key parties involved.

SECTION 1: SECTION 515 PROGRAM

2.2 OVERVIEW

The Section 515 program offers direct loans to eligible borrowers to provide economically designed and constructed housing and related facilities for very low-, low-, and moderate-income households; elderly households; and persons with disabilities living in rural areas. This section of the chapter describes:

- The types of projects allowed;
- The types of loans available; and
- Rental assistance available from the Agency.

2.3 TYPES OF PROJECTS

There are four basic types of rental projects that can be developed using Section 515 loans:

- Family projects;
- Elderly projects;

- Congregate projects; and
- Group homes.

In addition, Section 515 loans can be used to finance rural cooperative housing projects. The Agency also allows mixed projects that contain both family and elderly units.

The housing must be economical and must not include elaborate features, but it must be adequate to meet tenants' needs. The project should be of average quality and cost. With the exception of off-farm labor housing, all projects must be developed in locations that qualify as rural areas.

A. Family Projects

A family housing project is a rental property developed for occupancy by eligible very low-, low-, or moderate-income households.

B. Elderly Projects

An elderly project is a rental property that is developed for occupancy solely by eligible elderly households that include a tenant or cotenant that is disabled or age 62 years or older.

C. Congregate Projects

Congregate projects are rental properties developed for occupancy by eligible very low-, low-, and moderate income elderly households that need meals or other services to assist them in performing activities of daily living. Congregate projects consist of private apartments and central dining facilities in which a number of allowable preestablished services are provided to tenants. These projects are <u>not</u> designed to be nursing homes and, therefore, are not allowed to pay for the cost of medical- or healthcare-related services.

D. Group Homes

A group home is housing that is occupied by eligible very low-, low-, or moderate-income elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

E. Rural Cooperative Housing

Section 515 loans may be used to finance rural cooperative housing projects operated by nonprofit consumer cooperatives for the benefit of eligible very low-, low- and moderate-income members.

F. Mixed Projects

Mixed projects are properties developed with a portion of the units designated as family units and the remainder of the units established as elderly units. At the time the project is developed, the borrower must designate the units that will be operated as family units and those that will be operated as elderly units.

2.4 TYPES OF LOANS

The rules governing the origination of Section 515 loans differ slightly, depending upon the type of loan being made. The types of loans available under Section 515 include:

- Initial loans;
- Subsequent loans; and
- Assumed loans.

This section describes the three types of loans and how they differ. The first two types are discussed in further detail in HB-1-3560. The requirements and procedures for assumed loans and equity loans are covered in Chapter 7.

A. Initial Loans

Initial loans are made to projects with no existing Agency loan. Most initial loans are made to build new properties. However, the Agency makes initial loans for the rehabilitation of existing properties when it is in the Agency's best interest.

The interest rate for these loans is set at the note rate established by the Agency in RD Instruction 440.1. The Agency then provides interest credit assistance, which reduces the effective interest rate to 1 percent[1]. Interest credit is only provided for units occupied by eligible tenants paying at least 30 percent of their income for rent. The administration of interest credit is covered in this handbook and HB-2-3560.

The Agency establishes the term of these loans to correspond to the expected useful life of the property. The maximum term is 30 years with an amortization period not to exceed 50 years. Generally, initial loans are made for a term of 50 years, with the exception of properties where the expected useful life is a shorter period (e.g., manufactured housing).

[1] Some existing projects do not receive interest credit, while others receive interest credit that reduces the interest rate to three percent. However, all initial loans made by the Agency following the publication of this handbook will receive interest credit as described here.

B. Subsequent Loans

Subsequent loans can be issued during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property or in conjunction with the transfer of a property where the purchaser is assuming the initial Agency loan. The key differences between processing requirements for subsequent and initial Section 515 loans are discussed in Chapter 10 of HB-1-3560. Guidance regarding the requirements and procedures for processing project transfers is covered in Chapter 7. Subsequent loans may also be used to finance equity to avert prepayment of the project.

C. Assumed Loans

Section 515 loans may be assumed in conjunction with the transfer of ownership of the property. The terms and conditions of the assumption depend upon the needs of the project at the time of the transfer. The procedures for processing transfers and assumptions are presented in Chapter 5.

1. New Rates and Terms Assumption

Most assumptions of Section 515 loans are new rates and terms assumptions—that is, the purchaser assumes responsibility for all or a portion of the remaining debt. To conserve the Agency's budgetary resources, the transaction does not involve paying off the old loan and issuing a new initial loan. Instead, the purchaser assumes the outstanding debt, which is reamortized at new rates and terms. New rates and terms assumptions are used when the purchaser will experience financial difficulties under the terms of the initial loan or when a change in rates and terms is necessary to facilitate the transfer. Purchasers may apply for subsequent loans to make up the difference between the amount of debt assumed and the purchase price or to address physical needs at the project.

2. Same Rates and Terms Assumption

Transfers may also take place in conjunction with a same rates and terms assumption. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

2.5 AGENCY RENTAL ASSISTANCE

Owners of projects located in areas where prospective tenants are likely to be rent overburdened or existing tenants are already overburdened can apply for rental assistance administered by the Agency. This rental subsidy assists tenants by allowing them to pay 30 percent of adjusted income for rent, thereby reducing the financial burden on the household. The Agency pays the difference between the tenant contribution and the approved shelter costs for the unit through the rental assistance contract with the borrower.

2.6 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

To maximize the number of units produced with Section 515 loan funds, the Agency gives preference to project applications for new loans that leverage other funds, thereby reducing the amount of Section 515 loan funds needed to develop the project. The greater the leveraging proposed in a project application, the greater the preference for funding. Examples of funds that count as leveraged funds include borrower resources beyond the minimum required amount, equity generated by the sale of low-income housing tax credits (LIHTCs), a second loan from another lender, or a grant from a State or Local public agency or other source.

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SECTION 2: SECTION 514/516 PROGRAM

2.7 TYPES OF PROJECTS

The Section 514/516 Farm Labor Housing program provides funds to support the development of housing for farm labor. Section 514/516 assistance differs from the Section 515 loans in the following ways:

- The objective of the program is to provide housing for farmworkers;
- There are no rural restrictions; and
- Agency grants are available to support the development of these projects.

Section 514/516 assistance may be used for off-farm labor housing projects and Section 514 assistance may be used only for on-farm labor housing projects. Only Section 514 assistance may be used in conjunction with Federal LIHTCs.

A. Off-Farm Labor Housing

The Agency is authorized to make loans and grants for financing off-farm labor housing to broad-based nonprofit organizations; nonprofit organizations of farmworkers; Federally recognized Indian tribes, agencies, or political subdivisions of State or Local Government; and public agencies, such as local housing authorities. Section 514 loans can be made to limited partnerships in which the general partner is a nonprofit entity.

B. On-Farm Labor Housing

On-farm labor housing is designed to provide adequate housing for farmworkers involved in a specific farming operation. Individual farmers, family farm corporations or partnerships, or associations of farmers may develop these projects but must operate them on a nonprofit basis. To qualify for occupancy, an individual or a household must simply be employed as part of the farming operation. There is no income restriction governing occupancy. However, immediate family members of individuals with an ownership interest in the farm are prohibited from living in this housing.

2.8 LOANS AND GRANTS

The Agency offers loans and grants to finance Farm Labor Housing projects. Chapter 12 of HB-1-3560 provides more information about the origination process for these loans and grants.

A. Farm Labor Housing Loans

Section 514 loans for farm labor housing projects are very similar to Section 515 loans, but they differ in two important ways:

- These loans carry a 1 percent effective interest rate (i.e., there is no interest credit).

- The maximum term for these loans is 33 years.

These loans can be used to finance either Off-Farm or On-Farm Labor Housing projects.

At one time, loans for both types of projects were processed on a first-come, first-served basis. Today, lending decisions regarding loans for off-farm labor housing projects are handled through a competitive Notice of Funding Availability (NOFA) process, while loans for on-farm labor housing projects are still processed in the order that they are received.

B. Farm Labor Housing Grants

Section 516 grants may only be used to support the development of off-farm labor housing projects. These grants may be used for the same purposes as Section 514 loans when there is reasonable doubt that the housing would not be provided without the grant.

2.9 RENTAL ASSISTANCE

Applicants for Section 514/516 assistance for off-farm labor housing projects may also apply for rental assistance administered by the Agency. The requirements for obtaining rental assistance are the same as for Section 515 projects. On-farm labor housing projects are not eligible for this rental assistance.

2.10 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

Like the Section 515 program, the Agency gives preference to applications for off-farm labor housing projects that leverage other sources of funds. There is no leveraging preference for on-farm labor housing applications.

SECTION 3: OVERVIEW OF MULTI-FAMILY PROJECT SERVICING

2.11 KEY PROJECT SERVICING ACTIVITIES AND THIS HANDBOOK

The goal of the Agency's servicing efforts is to ensure that projects fulfill the terms of their loan or grant agreement and provide fair, consistent processing of servicing requests. Project servicing involves the following activities:

- Account servicing;
- Reviewing requested changes in the ownership entity;
- Evaluating and processing project transfer requests;
- Addressing security restructuring requests;
- Identifying and recapturing unauthorized assistance;
- Addressing borrower defaults and evaluating workout agreements;
- Processing loan restructuring requests;
- Foreclosing and liquidating projects in default;
- Managing and disposing of inventory property; and
- Evaluating and processing prepayment requests.

This handbook presents the program requirements in each of these areas and describes the Agency's procedures for fulfilling its responsibilities.

In addressing each topic area, the handbook first presents the requirements and procedures for Section 515 rental projects and then discusses differences or additional requirements for other types of projects (e.g., congregate housing, farm labor housing, cooperatives).

2.12 PROJECT SERVICING PROCEDURES FOR MULTI-FAMILY HOUSING PROJECTS

Chapters 3 through 13 describe the program requirements for Section 515 projects.

A. Automated Systems (Chapter 3)

This chapter describes the Agency's four primary automated information management systems—Industry Interface, the Automated Multi-Family Housing Accounting System (AMAS), the Multi-Family Integrated System (MFIS), and the Prepayment Tracking and Concurrence (Pre-Trac)—including their purpose and capabilities, staff responsibilities, and training and certification requirements.

B. Account Servicing (Chapter 4)

This chapter covers routine transactions involving the borrower's repayment of the loan obligation, including payment processing, tracking project accounts, and final payments.

C. Ownership and Organizational Changes (Chapter 5)

Changes in the borrower entity require Agency notification and, in specific cases, Agency consent. This chapter outlines the requirements regarding borrower requests involving these changes and the procedures for addressing these changes.

D. Determination of Project Suitability (Chapter 6)

When there are loan repayment or compliance problems with a project and the Agency is considering special servicing actions, or prior to making a subsequent loan, the Loan Servicer must determine that the property remains suitable as a program property. This chapter is designed to assist the Agency, and the Loan Servicer in particular, to make an analysis of a project's suitability and to determine that it meets the principles and objectives of the Agency.

E. Transfers of Project Ownership (Chapter 7)

When borrowers seek to transfer their projects to a new ownership entity, the transfer must be performed in a manner consistent with the program requirements to ensure that the project continues to address program objectives and the Agency's security interests are protected. This chapter explains the requirements and procedures for completing project transfers.

F. Security Restructuring Requests (Chapter 8)

As project conditions change over time, it may become necessary to request a restructuring of the security for the loan. The Agency's requirements and procedures for filing these requests are covered in this chapter.

G. Unauthorized Assistance (Chapter 9)

If borrowers or tenants receive assistance for which they are ineligible, the Agency will take steps to recapture this unauthorized assistance. This chapter discusses the Agency's requirements and procedures for identifying and collecting unauthorized assistance.

H. Compliance Violations, Defaults, and Workout Agreements (Chapter 10)

The Agency will monitor borrower performance using the procedures presented in Chapter 9 of HB-2-3560. Borrowers who fail to comply with program requirements will be notified of compliance violations and the need to correct the deficiencies. This chapter describes the servicing actions in response to compliance violations and the

additional servicing actions taken by the Agency in the event violations go uncorrected and the borrower falls into default.

I. Loan Restructuring (Chapter 11)

When borrowers encounter changes or difficulties beyond their control that affect the financial viability of the project, they may ask for the Agency to approve restructuring of its financing as one course of financial relief for the project. Also, borrowers with more than one Agency loan may be able to request restructuring changes that simplify administration of the loans. This chapter presents the requirements and procedures for Agency review and approval of these requests.

J. Account Foreclosure and Liquidation (Chapter 12)

When borrowers go into default under the terms of their loan agreement, the Agency will review the case and determine whether to accelerate the loan and initiate foreclosure proceedings. The procedures for making this determination are covered in this chapter.

K. Other Special Cases (Chapter 13)

There are a number of special circumstances that borrowers may face during the life of a loan that require special servicing actions by the Agency. The special cases covered in this chapter include bankruptcy, death of a borrower, abandonment, and valueless liens.

L. Management and Disposal of Real Estate Owned Property (Chapter 14)

Real estate owned (REO) property consists of projects where the Agency has assumed ownership as a result of foreclosure. This chapter presents Agency procedures for managing and disposing of these projects in a manner that is in the best interest of the government and of any tenants of the projects.

M. Project Preservation (Chapter 15)

Borrowers receiving loans prior to December 15, 1989 may prepay their loan obligations under the terms of their loan agreements. In an effort to preserve such units as affordable housing, the statute for the program directs the Agency to make reasonable efforts to extend the low-income use of the project. This chapter presents the requirements and procedures for borrower requests and Agency evaluation of such requests.

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CHAPTER 3: AUTOMATED SYSTEMS

3.1 INTRODUCTION

Many of the Agency's account servicing activities are dependent on data submitted to the Agency by tenants and borrowers. These data are tracked by Loan Servicers using the Agency's automated systems. This section describes the Agency's four primary automated information management systems—the Management Agent Interactive Network Connection (MINC), the Automated Multi-Family Housing Accounting System (AMAS), the Multi-Family Information System (MFIS), and the Prepayment Tracking and Concurrence (Pre-Trac)—including their purpose and capabilities, staff responsibilities, and training and certification requirements. Pre-Trac and the Preservation Information Exchange (PIX) to support prepayment requests are discussed in more detail in Chapter 15.

It is important to understand that while this section identifies the specific activities that may be accomplished using the various automated systems, many of the activities listed for a particular system cannot be accomplished without inputs from one or more of the others. For instance, monthly loan payment amounts are tracked using AMAS, but those amounts cannot be determined without inputs from MFIS. Similarly, while MFIS is used to identify and track the status of borrower noncompliance, the standards by which compliance is measured come from AMAS.

Every Rural Housing Service (RHS) employee is required to be familiar with each of the Agency's automated systems. This includes gaining familiarity with not only the basic information in this chapter, but the more detailed user manuals for each system and periodic training offered to staff.

3.2 MANAGEMENT INTERACTIVE NETWORK CONNECTION

MINC is an automation initiative being pursued by the Agency to reduce the cost of compliance and increase the effectiveness of supervisory actions in the Multi-Family Housing program.

A. Background

Before a borrower can submit a payment to the Agency for review and processing, the Agency needs to determine and inform the borrower of the correct payment amount. Before the payment amount can be determined, the borrower needs to collect and submit to the Agency the tenant data that is used in the calculation of rental assistance, interest credit, and ultimately, the "net" payment amount that must be submitted by the borrower. To make the required calculations, tenant data are entered into MFIS, and the outputs from MFIS are ultimately entered into AMAS for tracking. It is crucial that tenant data be correct, because about $1 billion in tenant subsidy is awarded annually based on each tenant's status.

Traditionally, borrowers have submitted tenant data to the Agency by mailing paper copies to the Servicing Office each month to reflect current occupancy status. In recent years, the Agency has been moving away from paper submissions toward electronic submissions through an automated interface with borrowers—MINC.

B. Purpose and Capabilities

MINC enables management agents to transmit tenant data electronically, via the Internet. In addition to tenant data, management agents can transmit *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*, and *Form RD 3560-10, Borrower Balance Sheet*. Data that are transmitted correctly, and contain changes that are within the allowable parameters, are automatically uploaded into MFIS. Data that are transmitted incorrectly, or that does not comply with Agency regulations, are "rejected" by MINC. Questionable data transactions, containing changes requiring review by the Loan Services, are held in a "pending" status in the MFIS electronic transmission web page. Borrower mail is sent to the management agent, detailing the result of each transaction transmitted such as accepted, rejected, pending, etc. The Loan Servicer reviews all transmitted transactions, through the use of a "Daily Report," to determine if there is any action necessary on the Agency's part. The Servicing Office sends out the MFIS notice of payment due report to the borrower, who reviews it for accuracy. If the borrower discovers any discrepancies in the report, a correcting transaction is transmitted or the Servicing Office is contacted for guidance. Once the report is determined to be correct, the borrower sends in the appropriate payment.

C. Staff Responsibilities

In accordance with 7 CFR Part 3560, all borrowers are required to electronically transmit their tenant and financial data for projects consisting of more than eight units. The Servicing Office Staff should contact all borrowers/management agents, and provide them with instructions for accessing and using MINC. The steps involved in this process are as follows:

- Contact the borrower/management agent, and verify that the taxpayer identification number on file with the Agency is correct for the management agent;

- Validate that all projects for said management agent are associated to the taxpayer identification number;

- Inform the borrower/management agent to access the MINC Web site at https://usdaminc.sc.egov.usda.gov, and print a copy of the training handbook; and

- Instruct the borrower/management agent to follow the step-by-step instructions contained in the training handbook to obtain a MINC access code and password. The help manual should be consulted for any problems they encounter while completing this process. In the event that questions still exist after having consulted the help manual, the borrower/management agent should then contact the Servicing Office for assistance.

The borrower/management agent will be required to electronically accept an automated version of the Trading Partner Agreement (TPA) while obtaining their MINC access code and password. The date of acceptance is stored within the system should this information be needed at a later date.

The Servicing Office goals are to:

- Maintain project information on MFIS, completing primary processing of submissions of changes to tenant data between the first and tenth days of each month;

- Provide MFIS reports in a timely manner, or as requested by the borrower/management agent; and

- Confirm the receipt of data transmission when asked.

The Servicing Office should refer borrowers/management agents to vendors to troubleshoot software as needed. Some borrowers/management agents with small projects do not use vendor software; instead, they transmit through MINC using the "Fill-a-Form" option and may need more assistance from the Servicing Office. Any automation or program-related issues that are discovered by the Servicing Office should be reported to the State Office.

D. Benefits of MINC

MINC benefits all parties involved. Electronic submission of data saves borrowers the burden and cost of generating and mailing paper documentation to the Agency. The Agency saves the burden and cost of handling mail, sorting and copying paper documentation, and reentering tenant data by hand. Freeing staff from clerical tasks allows them to focus on analytical responsibilities, such as reviewing occupancy patterns to uncover civil rights violations, tenant fraud, unacceptable management practices, and warning signs of occupancy problems.

In addition, MINC allows borrowers more time to meet deadlines. Changes submitted through MINC are required to be filed by the tenth of the month, an extension of 10 days. For borrowers, this provides more time to ensure that their information is assembled properly, and is complete and accurate. More accurate information results in fewer mistakes to correct with the borrower. Even if there are mistakes, MINC allows for next-day response by the Agency. As a result, corrections can be made while the borrower's memory is still fresh.

MINC also reduces the chance that borrowers will be charged overage for late certifications, which can result in a substantial penalty for borrowers, management agents, and site managers. Extended submission deadlines and faster turnaround on submission reviews reduce the possibility of overage being charged for late data.

E. Staff Training and Certification Requirements

Beyond gaining familiarity with the functions of the system, there are few formal training or certification requirements for Loan Servicers using MINC.

3.3 AUTOMATED MULTI-FAMILY HOUSING ACCOUNTING SYSTEM

A. Purpose and Capabilities

AMAS maintains loan account information, tracks loan status, and disburses project subsidy. AMAS has been operational since 1985 and is located on the U.S. Department of Agriculture (USDA) Kansas City mainframe. The Systems Development Division in St. Louis administers AMAS.

AMAS is the Agency's primary financial accounting system. Any data relating to a borrower's account (e.g., payment amount, payment due date, account status) are tracked using AMAS. In addition, payment entry, verification, and reconciliation are accomplished using AMAS.

In 1993, AMAS was expanded to include pre-application and application data for tracking and reporting purposes. Several aspects of this enhancement are still under development or testing. When fully operational, the Agency will have the ability to compare and analyze line item construction costs; track multistate applicants and borrowers; and produce meaningful reports on applications, projects, and borrowers to satisfy the Freedom of Information Act (FOIA) and Congressional requests.

B. Staff Responsibilities

Loan Servicers using AMAS are responsible for the following activities:

- Closing loans, including reamortized loans;
- Disbursing loan funds;
- Determining note, rental assistance, and interest credit payment amounts;
- Determining payment due dates;
- Processing loan payments, including final loan payments;
- Converting accounts from Daily Interest Accrual System (DIAS) to Predetermined Amortization Schedule System (PASS);
- Determining current loan balances for transfer;
- Processing payments made at transfer closing;
- Obligating the transfer and subsequent loan;

- Adjusting accounts in response to unauthorized assistance;
- Processing recaptured unauthorized assistance;
- Adjusting accounts for interest rate changes;
- Tracking rental assistance;
- Tracking inventory property status and acquisitions;
- Tracking Servicing Office and overall Agency loan and subsidy totals;
- Tracking and correcting account discrepancies; and
- Tracking account payment history.

On the AMAS main menu, Screens #1–7 are transactional fields where processing related to appropriations, obligations, disbursements, loan servicing, inventory property, tenant file processing, and ledger balancing are accomplished. Screen #8 is a view-only screen that can be accessed to ensure that previous transactions entered into the system were processed correctly and in a timely manner. Screens #9 and 10 are also view-only screens where account discrepancies can be flagged and reviewed. Screens #11 and 12 show the payment history for a project, including the distribution of principal, interest, and subsidy. Screen #13 shows all miscellaneous information not related to principal and interest payments. Screen #14 is where payments are processed.

Some of the screens within AMAS can only be accessed by particular State Office or Finance Office Staff, depending on the nature of the transaction. For instance, transfers can only be processed by certified staff in the Finance Office. In general, new staff and staff without proper certifications have system access which is limited to view-only screens. All screens are accessed by entering the project case number.

C. Staff Training and Certification Requirements

Loan Servicers must be certified by the State Director to process payments in AMAS. The AMAS Coordinator in each State is responsible for the payment processing certification process and will make recommendations to the State Director, based on certification examination. Each Field Office should have at least two certified staff who can process payments. Uncertified staff may access the view-only screens within the system, but cannot alter any of the data.

1. Basic Skills Required

The basic areas a Loan Servicer must master to receive certification include the following:

- The employee must successfully review and process payments for three call dates;

- The employee must successfully correct any blocks that are out of balance; and

- For offices on the wholesale lockbox system, the employee must properly prepare the Field Office Remittance Reconciliation Report and all related forms for submission to the wholesale lockbox.

2. Procedures for Certification Training

The procedures for certification training are as follows:

- The employee will be trained by the AMAS Coordinator, or by a qualified State Office or Field Office employee. The training must cover the following areas:

  ◊ Reviewing and processing the borrower's payment transmittal;

  ◊ Understanding the payment logic;

  ◊ Signing onto the AMAS Cash System (AMAS-CSH);

  ◊ Inputting regular payments;

  ◊ Correcting out-of-balance blocks;

  ◊ Processing miscellaneous collections; and

  ◊ Submitting checks, cash, and accounting data to the Finance Office.

- The employee will sign onto the AMAS test data base (TS2) and make entries into the AMAS-CSH system. The Information Resources Manager (IRM) is responsible for obtaining a TS2 identification number for the trainee.

- The trainee will make copies of all the records related to preparing the test collections and will include them in an envelope as if they were being mailed to the Finance Office. The envelope will be marked "Payment Certification for (trainee name)" and submitted to the AMAS Coordinator.

3. Recommendation of Certification

The AMAS Coordinator will review the balanced blocks and the accounting data envelope prepared for the examination. When the employee has demonstrated an understanding of the payment process and proficiency in all steps listed above, the AMAS Coordinator will recommend certification to the State Director. The State Director will:

- Instruct the IRM to notify the Security Officer in the Finance Office to add AMAS payment process to the employee's user identification number; and

- Notify the Loan Servicer and employee, by letter, of the employee's certification to process payments online in AMAS. The letter must list the possible reasons for withdrawal of certification.

4. Monitoring Payment Processing

After certification, the AMAS Coordinator will periodically monitor Field Office use of the online payment process to ensure that payments are being input properly and blocks are balancing. For newly certified employees, monitoring should be daily for a 30-day period. For experienced employees, monitoring should be no less than monthly, provided monitoring reports do not indicate any of the problems that could lead to withdrawal of certification.

A log of each monitoring activity should be kept by the AMAS Coordinator for documentation using *Form RD 3560-64, Online Payment Certification Monitoring Log*.

5. Withdrawal of Certification and Recertification

Certification may be withdrawn from an employee for any of the following reasons until corrective action training has been given:

- Block(s) has remained out-of-balance for 5 working days and the condition is due to employee error.

- The effective date of the payment and the call date differ by more than 3 days and there is not sufficient justification (e.g., office was closed on the regularly scheduled work day that the payment was received; weekend and holidays caused a 3-day delay before the payment could be processed).

After the third occurrence of any of the above errors in a 12-month period, the State Director will notify the Loan Servicer and employee in writing that certification may be withdrawn. The notice will include plans and requirements for remedial training.

The State Director will withdraw certification after the fourth occurrence in a 12-month period of any of the above errors. The State Director will notify the Loan Servicer and employee in writing, with a copy to the IRM for the State. The IRM will notify the Security Office in the Finance Office to remove online payment authority from the employee's identification number.

6. Retraining

An employee should be retrained immediately when a payment processing problem occurs as a result of an employee error. This training should cover the areas causing problems and should prevent recurrence of the error. After certification has been withdrawn, the State Director must determine whether it is desirable for the employee to process payments. If so, the retraining should be performed immediately. The employee may be recertified if retraining has been completed, the employee demonstrates the

necessary skills to process payments, the AMAS Coordinator recommends recertification, and the State Director concurs.

3.4 MULTI-FAMILY INFORMATION SYSTEM

A. Purpose and Capabilities

MFIS assists Servicing Offices in monitoring the Multi-Family Housing program, maintains data on clients, and provides comprehensive and flexible reporting. MFIS began as an automated version of the Management Card System and has evolved into an integrated, relational database which is accessible via the Internet.

MFIS was designed to improve management and supervision routines in Servicing Offices. It automates most of the monitoring and scheduling systems being used by the Servicing Offices and provides the analytical tools to review budgets and financial information. Part of MFIS is a classification system that uses information entered during normal supervisory activities to identify projects needing additional servicing attention. When MFIS is fully implemented, manual tracking and analysis systems will be discarded at all administrative levels of the Agency, and this will greatly improve the Agency's ability to track program status.

MFIS incorporates the functions previously provided under the old Multi-Family Housing Tenant Filing System. MFIS is used by the Agency to track tenant data, and it is employed mainly to ensure that each tenant receives the correct amount of subsidy. MFIS uses the tenant data to calculate tenant rents and rental assistance, which drive many subsequent account servicing activities. MFIS is also the source for occupancy statistics used to describe Multi-Family Housing program beneficiaries.

MFIS is the primary tool used by the Agency to track the status of borrowers' compliance with loan agreements and all other program requirements. Account status data from AMAS are transferred to MFIS, where Loan Servicers use them to monitor the status of borrower compliance. For instance, the system holds data on project classification based on compliance status (i.e., Classification codes A, B, C, or D). In addition, the system tracks the status of project budgets (i.e., when they are due, when they are received, and when they are approved).

The goal of using MFIS for tracking is to identify borrower compliance violations, as well as to track the status of servicing letters, workout agreements, and other Agency servicing actions. For instance, MFIS tracks the 15-day period for responses to servicing letters or monitoring letters and alerts staff to the need for follow-up when that period has expired.

MFIS also is used to track each state's performance in meeting Agency goals, and evaluate those states that may need additional assistance in determining solutions to problem accounts and the effectiveness of actions previously taken. Many states use the information from MFIS in monthly staff meetings and to provide information to borrowers. MFIS allows for timely assembly of this information with minimal effort from the Servicing Offices.

B. Major Components of MFIS

The MFIS home page displays icons that each represent a Web page of their own, that link to each other and are capable of interacting by accessing the data contained therein. The four main icons a Servicing Office should be concerned with are Projects, Customers, Reports, Electronic Transmissions, and Message Board. Each web page contains links for data input and analysis of important multi-family housing portfolio issues such as borrower compliance with their loan agreement/resolution, management efficiency, financial stability, occupancy trends, rent structures, and identities-of-interest, as well as program strengths and deficiencies. Moreover, MFIS archives a history of the multi-family housing portfolio nationwide, providing information necessary for determining the need for program changes and/or enhancements as well as funding needs.

- **Projects.** This page is used when working on information specific to a single project. It contains the data on the borrower, management agent, project tenants, type of project, and the like. Basically it contains all information that was formerly contained on the Management Card System for each project. Any incorrect information on this page could lead to improper calculations on *Form RD 3560-29, Notice of Payment Due Report*, that the borrower uses to make their monthly/annual installment from, thus causing unnecessary delinquencies.

  The Projects page is also where the Loan Servicer maintains information concerning borrower/management agent compliance with Agency regulations. One link on this page is Supervisory Activities. Supervisory Activities, when properly populated, can serve as an excellent tickler system to let the Servicing Official know when action is needed on their part. The same is true for the link Servicing Efforts, Findings, Financial Instruments, and Rents. When all components are analyzed, a clear and concise picture of the needs of the project can easily be determined.

- **Customers.** This page should be used when working on information across projects or specific only to the borrower, key member, or management agent. This is the page used to enter the key members of the borrower and management agent. It also allows the user to access all of the projects managed by a particular management agent, enabling an identical change to multiple projects with ease.

- **Reports.** This page contains predesigned reports by category, such as borrower, financials, findings, management agent, project, project summary, tenant, and tracking. Under each category, several different reports that may be generated are listed. The user is allowed to complete various data fields to allow one to zero in on the particular information that is desired. *The accuracy of these reports is based on the information that has been input into the Projects and Customer Web pages.*

- **Electronic Transmissions.** This page allows the MFIS user to view the individual transactions that have been electronically transmitted by the borrower/management

agent. It is an important tool in assisting the borrower/management agent in correctly transmitting the data necessary to reflect the correct tenant and/or financial data.

- **Message Board.** Below the icons for the individual Web pages is a link to the message board. Each user of MFIS is encouraged to view the message board on a regular basis. This shows information on changes that have been made to the system. Step-by-step instructions for the input of all requested and/or required data are provided in the training manuals that are accessible from the message board.

C. Staff Responsibilities

Loan Servicers are responsible for populating all data fields contained in the MFIS system with accurate and current information. The upgrading of the MFIS system is an ongoing process. It is extremely important that the information contained in MFIS III for each borrower/management agent/project be input and accurate to attain a smooth transition to the Phase IV upgrade.

3.5 PREPAYMENT TRACKING AND CONCURRENCE

Pre-Trac is a Web-based automated application that allows the Agency to significantly reduce the reporting burden required to process and monitor Multi-Family Housing prepayment activity. This means that the Agency enters prepayment-tracking information once for use by all administrative levels. State and Servicing Offices use Pre-Trac to process all prepayment requests to meet the Agency's requirements. Pre-Trac is designed to lead the user through the statutorily prescribed prepayment process.

The Office of Rental Housing Preservation (ORHP) uses Pre-Trac to issue all concurrence and authorizations of incentives to avert prepayment, and equity loans and prepayments. See Chapter 15 for more detailed information on using Pre-Trac.

3.6 FURTHER INFORMATION

Because there is a detailed users' manual for each of the Agency's automated systems, the discussion provided here is intended to be more of a basic introduction to the systems and their uses and requirements than an exhaustive step-by-step tutorial. Agency staff requiring more detailed information on any of the automated systems should refer to the relevant users' manual.

CHAPTER 4: ACCOUNT SERVICING

4.1 INTRODUCTION

To ensure that program objectives are met and that borrowers do not default on their loans, the Agency has specific procedures for servicing borrower accounts. These procedures are designed to ensure that loan payments are received on time and in the proper amounts; payments are properly applied to the appropriate account; past due accounts are serviced correctly; late fees are assessed for late payments; and procedures for final loan payments are followed. Diligent management of the account servicing process through promptly and accurately recording payments and tracking late payments is an effective method to reduce unnecessary delinquencies.

This chapter presents the Agency's procedures for servicing borrower accounts. It describes the procedures that all Loan Servicers must follow when servicing accounts to protect the Government's interest in the loan and the property.

4.2 OVERVIEW

Agency regulations in 7 CFR 3560.401 through 7 CFR 3560.403 establish borrowers' responsibilities and the actions the Agency may take to collect timely loan payments from borrowers, protect its interests and the security of its loan, and assist borrowers in meeting the objectives and requirements of the loan. These regulations require that borrowers repay their loans to the Agency according to the specific provisions of their debt instruments and operate their facilities in accordance with requirements of the rule and other applicable Federal, State, and Local laws. The Agency may reject any servicing request by a borrower if it is not in the best interest of the Government or tenants.

Most servicing requirements and procedures are the same for Daily Interest Accrual System (DIAS) accounts and Predetermined Amortization Schedule System (PASS) accounts, with the exception of the assessment of late fees, which only applies to PASS accounts. Payments under DIAS are not assessed late fees because additional interest is charged automatically, based on the number of days the past due balance is outstanding.

SECTION 1: ACCOUNT SERVICING REQUIREMENTS
[7 CFR 3560.403 AND 7 CFR 3560.404]

The Agency's regular account servicing requirements cover the following major topic areas: loan payments, late fees, waivers, servicing past due accounts, conversion of accounts from DIAS to PASS, and final loan payments. This section describes the regulatory requirements for each area.

4.3 LOAN PAYMENTS

Borrower loan payments are due on the <u>first day of each month</u> unless otherwise established in the debt instrument executed with the Agency. A borrower is in default of loan

agreements when the Agency has not received the full payment by the first day of the month. The Agency is under no obligation to offer borrowers loan servicing other than actions consistent with debt instruments and other agreements. However, the Agency does not pursue legal action to cure the default until a borrower is 60 days delinquent. If a borrower with a PASS account has not paid the full amount by the tenth day of the month, a late fee may be incurred.

4.4 LATE FEES (PASS ACCOUNTS ONLY)

The Agency will charge a fee for late payments under PASS accounts, equal to 6 percent of the note installment. Late fees are charged if any portion of a note payment exceeding $15 is late (i.e., outstanding after the tenth day of the month). The Agency may charge late fees only once for each regular installment or portion thereof.

Late fees are an owner expense and, as such, may not be charged to the project. The amount of the late fees is not negotiable, and the borrower is not entitled to appeal rights. The Finance Office notifies all late borrowers with PASS accounts of late fees and the payment due, not including overage and rental assistance calculations. The Loan Servicer should follow up with the borrower on this notification in an effort to collect the amount due before an account becomes 30 days past due.

4.5 LATE FEE WAIVERS

The State Office may waive late fees only for circumstances beyond a borrower's control or when granting the waiver is in the best interest of the Government. Waivers are issued at the Agency's discretion and Field Office Staff are under no obligation to grant waivers.

4.6 PAST DUE ACCOUNTS

A. Past Due Payments

The Agency considers a borrower to be delinquent if any past due amount remains after the payment due date. If a delinquency exists, the Agency immediately contacts the borrower and attempts to collect the amount due.

B. Interest on Past Due Payments (PASS Accounts Only)

When a regular payment continues to be past due on the first day of the month following the payment due date, the Agency charges interest at the note rate on the unpaid delinquent principal amount. Interest is charged from the date the principal was due until all applicable payments are current in accordance with the number of full installments required by the *Form RD 3560-52, Promissory Note*, and is in addition to the scheduled interest of the regular payment. The interest on delinquent principal, the unpaid delinquent principal, any applicable late fees, and recoverable cost charges are added to the regular payment amount due for the next month to determine the total amount due as of the first of the month following the delinquency.

Example – Determining Days for Past Due Accounts

If a borrower fails to make a scheduled payment in full due on June 1, the following example demonstrates how the Agency calculates past due charges:

June 1 – Payment due date.

June 2 – Payment is 1 day past due. No Agency action taken.

June 11 – Payment is 11 days past due. Late charge applied on overdue payments.

June 30 – Borrower is delinquent and 30 days past due. Agency begins special servicing actions in accordance with Chapters 10 and 12.

C. Special Servicing Action

Borrowers with accounts 30 days past due may be subject to the special servicing provisions outlined in Chapters 10 and 12 of this handbook.

4.7 CONVERSION FROM DIAS TO PASS

To facilitate and standardize its servicing efforts, the Agency requires that all new loans be closed and serviced using PASS. The only exceptions are off-farm and on-farm labor housing loans, which may be closed on either DIAS or PASS. Farm labor loans may be closed on DIAS if the farm operation is such that the annual payment corresponds to the timing of usual farm income.

Borrowers with DIAS accounts, except for farm labor housing loans, must convert to PASS if they request servicing actions that involve a change in the terms of their loan (e.g., credit sales, reamortizations, equity incentive loans, loan consolidations, and project transfers) or if they request subsequent loans.

4.8 FINAL LOAN PAYMENTS

The Agency will not accept a final loan payment unless applicable prepayment requirements have been satisfied, and the documents establishing any ongoing use restrictions accepted by the borrower are executed.

A borrower's final loan payment must include repayment of all outstanding obligations to the Agency. The Agency will apply any remaining supervised funds to the borrower's account or return such funds to the borrower following acceptance of final payment. At the borrower's request, the Agency will provide a written statement indicating the amount necessary to pay the account in full.

Suitable forms of payment include cashier's check, money order, or bank draft. If a borrower uses forms of payment that require special handling, the borrower is responsible for the cost of such handling. When payment is provided in a form that is not the equivalent of cash, the Agency will consider a payment to be received at the time the funds have been successfully transferred to the Agency. This can now be accomplished electronically through Pre-Authorized Debit (PAD).

The Agency will release security instruments when full payment of all outstanding obligations to the Agency has been received and accepted. If the Agency and the borrower agree to settle the account for less than the full amount owed, the Agency may release security instruments when the borrower has paid all agreed-upon obligations in full. Recording costs for the release of the security instruments will be the responsibility of the borrower, except where State law requires the mortgagee to record or file the satisfaction.

If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of receipt of the refund.

The Agency may collect any account balance that results from an error by the Agency in handling final payments.

SECTION 2: PROCESSING TENANT CERTIFICATIONS

4.9 OVERVIEW

For borrowers to qualify for interest credit or rental assistance, they must demonstrate that their tenants meet the income and household size eligibility limits delineated by the Agency. This section describes the Agency's policies and procedures for processing tenant certifications, including verification that the information is true and accurate.

4.10 REQUIREMENTS OF THE RULE

For each occupied unit under lease, borrowers must have a current tenant certification or recertification on file with the Agency to be eligible for interest credit or rental assistance. The Agency may charge borrowers overage and withhold rental assistance payments for units without a valid and current tenant certification. These requirements protect the Government's interest by ensuring that only eligible units benefit from Agency subsidy payments. They also protect tenants' interest by reserving subsidy benefits for those who actually qualify for them.

4.11 GENERAL PROCEDURES

A. Timely Submission and Overage Charges for Late Submissions

Borrowers must submit tenant certifications for new tenants and required recertifications for existing tenants no later than the tenth day of the month for the certification to be effective for that month. This deadline applies regardless of whether the certifications are being submitted through electronic transmission or in hard copy. Tenant certifications received after the tenth day of the month will be considered late. Borrowers are not eligible for interest credit or rental assistance for units with late certifications, and the Agency will charge the appropriate amount of overage until valid certifications are received in a timely manner for all units.

The tenth-day-of-the-month deadline applies regardless of whether the late certification in question relates to a new certification, an amended certification, a recertification, or a vacate notice. Any changes to tenant certifications that are effective as of the first day of the month must be submitted to the Agency by the tenth day of that month for the affected units to qualify for interest credit or rental assistance. If the changes are submitted after the tenth day of the month, the Agency will charge overage and the changes will be effective the first day of the following month. The Agency may remove a management agent if there is a pattern of failure to submit tenant certifications on time that results in excessive overage charges.

B. Waivers of Overage

In select cases where the late certification in question is a recertification and the information on the existing certification is still valid, the Agency may waive the overage charge for that month at its discretion.

In any other circumstance, borrowers may request waivers of overage from the Agency by submitting a letter to the Servicing Office justifying the reasons for the waiver. The criteria and procedures for requesting and granting a waiver of overage are virtually identical to those outlined in Section 3 of this chapter for waivers of late fees (e.g., the borrower must demonstrate that the late submission was due to circumstances beyond the borrower's control, or that the overage charge will place an unfair burden on the borrower). If a request for waiver of overage is denied, the charge must be paid as a borrower expense. Nonprofit borrowers and cooperatives may treat the charge as a project expense, although they must clearly demonstrate to the Agency why this is necessary (e.g., paying the overage from borrower funds would place an unfair economic burden on the borrower). As with late fee waivers, if a request for an overage waiver is denied, the borrower will be given appeal rights.

C. Verification and Processing of Certifications

Borrowers provide all tenant certification forms to the Servicing Office. The Loan Servicer will verify the data on current tenant certifications. Loan Servicers then enter data from verified tenant certifications—a function now handled through the Multi-Family Information System (MFIS)—and compare this information with the automated MFIS project worksheet (PRJ2000). Loan Servicers rely on the data in MFIS to calculate interest credit and rental assistance due the borrower, as well as overage due the Agency in cases of late certifications. All subsidy payments are based on tenants' occupying the units as of the first day of the month prior to the payment due date. For example, a payment due on July 1 is based on tenants' occupying the units June 1.

Note: *Form RD 3560-29,* is usually received during payment processing and is compared to the MFIS project worksheet.

Chapter 3, which includes a discussion of electronic transmissions, provides more detail on the procedures associated with verification and processing of tenant certifications.

D. Approval of Subsidy

The Agency will certify for interest credit or rental assistance only those tenants with current tenant certifications showing on MFIS when payments are being processed. Loan Servicers file a copy of the monthly project worksheet, *Form RD 3560-29,* to document the approved subsidies.

SECTION 3: LOAN PAYMENT PROCESSING

4.12 OVERVIEW

The Agency processes loan payments and subsidy requests according to the servicing and collection requirements of the individual loan. The requirements are established by the loan agreement or loan resolution, and *Form RD 3560-52*. There are a number of steps common to the processing of any loan payment, as outlined below.

4.13 NOTIFICATION TO BORROWERS OF PAYMENTS DUE

A. Factors Used to Determine Payment Amount

The Servicing Office specifies to each borrower on a monthly basis the amount of the current payment that is due, unpaid late fees, and delinquent payments due, if any, on the first day of the following month. This determination is accomplished by printing out the appropriate screens from the Automated Multi-Family Housing Accounting System (AMAS), which reflect unpaid late fees and delinquent amounts, borrower subsidy, and the net payment due from the borrower. Each tenant's rent payment is calculated by entering data from tenant certifications into MFIS. If the calculations on the tenant certification do not agree with MFIS, the Field Office will contact the borrower/management to resolve the discrepancy. The Agency also uses MFIS calculations to calculate interest credit and rental assistance payments due the borrower. All payment amounts are based on tenants' occupying the units as of the first day of the month prior to the payment due date. For example, a payment due on July 1 is based on tenants' occupying the units June 1.

B. Calculating Payment Amount

Loan Servicers determine the amount due from the borrower by using information from the automated MFIS project worksheet (PRJ2000) and AMAS screens to sum the following components of a payment due:

- Audit receivables (e.g., excess rental assistance, unauthorized assistance) as determined by MFIS;
- Late fees as determined by AMAS;
- Unamortized cost items (e.g., taxes, insurance, protective advances) as determined by AMAS;
- Amortized cost item loan installments as determined by AMAS and reflected on the MFIS *Form RD 3560-29* (included in the project payment) and in the project payment amount on *Form RD 3560-29*;
- Overage as determined by MFIS; and
- Debt service (i.e., interest and principal as determined by AMAS).

Note that audit receivables and cost items may be either unamortized or amortized. If they are amortized, a borrower may have up to five years to pay under the terms of an approved work-out agreement (see Chapter 10 for more information on workout agreements).

The Agency will count only those tenants who have current tenant certifications on MFIS for interest credit or rental assistance when processing payments. Loan Servicers file a copy of the monthly MFIS project worksheet, *Form RD 3560-29*, to document the approved subsidies. For a project receiving rental assistance, the rental assistance amount is applied as a credit to the total amount due as calculated on the project worksheet. The remaining balance is the net amount due.

Exhibit 4-1 illustrates how rental assistance and overage are calculated and the impact they have on the tenant's rent and the borrower's loan payment. If the amount of rental assistance exceeds the borrower's loan payment, the Agency will make a rental assistance payment to the borrower. In accordance with the Debt Collection Improvement Act of 1996, the Agency is required to send rental assistance checks via an electronic funds transfer to the borrower's bank account beginning in January 1999.

Exhibit 4-1

Overage and Rental Assistance

30% of Tenant Monthly Adjusted Income	Rental Assistance	Basic Rent	Note Rent	Overage	Actual Rent Paid by Tenant
$180	Not available ($0)	$200	$500	$0	Tenant pays Basic Rent, $200. Tenant is rent overburdened.
$180	$20	$200	$500	$0	Tenant pays $180.
$200	$0	$200	$500	$0	Tenant pays Basic Rent, $200.
$230	$0	$200	$500	$30	Tenant pays $230; $30 is considered overage.
$500	$0	$200	$500	$300	Tenant pays $500; $300 is considered overage.

C. Borrower Verification Of Payment Data

Borrowers may use a copy of the MFIS project worksheet report as Parts I and II in lieu of *Form RD 3560-29*. The Field Office will provide a copy of the MFIS project worksheet report to the borrower about the twentieth day of the month. When using the project worksheet report as Parts I and II, the borrower will verify the data, sign the report, and return it with the monthly payment to the Field Office. Borrowers using the report as Part II only will complete, sign, and attach Part I of *Form RD 3560-29* to the report before returning it with the monthly payment. Borrowers with HUD Section 8 units who are reporting overage payment and/or excess HUD contract rent to the reserve account are required to complete Part I of *Form RD 3560-29*.

4.14 PAYMENT DUE DATES

The regular payment due date is established in the Agency *Form RD 3560-52* for the project and is generally the first day of each month. The first regular amortized payment after loan closing for transfers, reamortizations, voluntary conversions, credit sales, or loans closed after interim financing must be at least 1 month from closing. For example, if a loan is closed on January 31, the first regular amortized payment will be due March 1. For multiple advance loans, the first payment must be at least 1 month after the final advance.

For transfers, payments on loans on PASS will be due on the next scheduled due date. For transfers converting from DIAS to PASS, regular amortized payments will be due 30 days from either the date of closing or the interest only installment, whichever is later.

4.15 ASSESSMENT OF LATE FEES

Payments for loans closed on PASS and DIAS are due on the first day of the month. The Agency charges late fees on PASS payments received after the tenth day of the month. The Finance Office automatically notifies each borrower of late fees for PASS payments that were outstanding as of the tenth day of the month. On or about the eleventh day of each month, the Finance Office will generate and mail *Form RD 3560-29A, Multiple Family Housing Statement of Payment Due,* to each borrower who is 30 days past due and/or owes late fees, showing the current monthly payment due, unpaid late fees, and past due payments due on the first day of the following month. This payoff statement will be determined from current Finance Office records but will not reflect overage due from the borrower or rental assistance due the borrower. The Finance Office mails a copy of this notice to the Field Office servicing the account.

Late fees collected by the Finance Office are deposited in the Rural Housing Insurance Fund (RHIF).

A. Agency Approval of Waivers Procedures for Granting Late Fee Waivers

Waivers to late fee charges may be granted only as follows:

- The State Director may grant a waiver for as many late fee charges as are justified by the facts of the case, based on a determination that the late fees would place an unfair burden on the borrower. For each waiver requested, the borrower must provide a written explanation of the circumstances that caused the late payment, proof that they were beyond the borrower's control, and a description of what actions will be taken to bring the account current. Waivers are granted on a case-by-case basis;

- There are only two circumstances under which the Agency will grant a waiver to late fees. The first is when the borrower is a board-managed nonprofit or cooperative, because they are the only entities on which the assessment of late fees would place an unfair burden. The second is where the Agency has agreed to accept deferred payments or partial payments as part of an approved workout agreement. In such cases, the State Director can grant as many waivers as are justified by the facts of the case (i.e., there is no annual limit on the number of waivers that may be granted);

- As noted above, late fees are an owner expense. As a result, they may not be charged to the project, except in the case of cooperatives, which can pay late fees from project expenses in cases where the fees are not waived;

- The Agency will not grant a waiver solely to correct a delinquency; and

- The State Director may authorize late fee waivers in cases where Agency error (e.g., an incorrect statement of the date a payment is due) leads directly to the late payment.

B. Required Submissions from Borrower to Receive a Waiver

Borrowers must submit a number of items to the Agency in order to receive a waiver. These include:

- A written explanation of the circumstances that caused the late payment;

- A description of the factors beyond the borrower's control (e.g., natural disaster); and

- A description of the actions that will be taken to bring the account current.

If the late payment is due to Agency error, the borrower need not submit the above-listed items. In such cases, providing notification to the Agency of its error will suffice, and loan services will promptly correct the error in the appropriate automated system(s).

C. Notification upon Granting A Waiver

When a waiver to late fees is granted, the State Director will notify the Servicing Office and the borrower on *Form RD 3560-28, Multi-Family Housing Exception to Late Fees*, completed according to the Forms Manual Insert (FMI), and enter the change into AMAS.

D. Denying Waivers

When an application for a late fee waiver is denied, the State Director must give the borrower appeal rights under 7 CFR Part 11.

4.16 PROCEDURES FOR PROCESSING PAYMENTS

A. Overview

Loan Servicers are responsible for administering the requirements for payment processing under the guidance and supervision of the State Director. Key steps in processing regular payments and advance regular payments are listed in Exhibit 4-2.

Exhibit 4-2

Key Steps in Processing Loan Payments

- Process payments upon receipt using Field Office Automated Multi-Family Housing Accounting System (AMAS) terminals;
- Review payments for accuracy, balance totals, access the accounting system, and enter appropriate amounts in the proper fields;
- When a payment is processed, the system will apply subsidy credit to the loan account before any payment or other credit is applied to the account. Subsidy credit will be applied first to accrued interest and then to principal after all interest is paid. Subsidy credit will not be applied to late fees, audit receivables, or recoverable cost charges;
- After a payment has been processed, any change in application that does not involve changes in cash may be made in the Servicing Office by properly trained and certified staff. If changes need to be made in a cash field, the AMAS Coordinator in the State Office can process the charge after performing a cursory review of account information; and
- Make modifications to the payment as necessary. Some examples of situations where modifications might be made include wrong date of credit, key punch errors, incorrect recording of rental assistance, and duplicate payments (see AMAS instructions for more information).

When a borrower remits a payment, AMAS will net enough rental assistance to bring the account status current and pay any unpaid overage, late fees, or interest on delinquent principal based on the date payment is received. If the account is on or ahead of schedule when the payment is received, enough rental assistance will be netted to pay one full installment and any unpaid overage, interest, or other obligation.

B. Borrower Submission

Borrowers must prepare and submit *Form RD 3560-29* providing the following information:

- Only tenants' occupying units the first day of the month prior to the payment due date;
- Interest credit and rental assistance only for tenants with current tenant certifications;
- Overage up to the market rent that must be paid to the Agency by the borrower for tenants without current tenant certifications unless there is a formal eviction in process. In that case, the payment will be based on the expired tenant certification; and

- The borrower may subtract any rental assistance due the project (supported by current tenant certifications) from the payment due and remit a net payment. Calculations supporting the net payment must be shown on Part I of *Form RD 3560-29*. AMAS will net enough rental assistance to bring the account status current and pay any unpaid overage, late fees, or interest on delinquent principal based on the payment receipt date.

C. Application of Payments

1. Regular Payments

The Agency has developed specific priorities for applying regular payments. Exhibit 4-3 lists these priorities in descending order.

AMAS also will apply regular payments on projects with an initial and subsequent loan according to the priorities in Exhibit 4-3. Each priority item will be paid for all project loans before moving to the next item. AMAS will apply payments for each priority item in accordance with the loan number, beginning with the initial loan and ending with the highest-numbered subsequent loan.

Exhibit 4-3

Priorities for Application of Borrower Payments to Outstanding Obligations

From highest to lowest, the priorities are:

- Amortized audit receivables;
- Unamortized audit receivables;
- All project late fees due;
- Amortized recoverable costs due;
- Unamortized recoverable costs due;
- Overage;
- All other interest due;
- Principal; and
- Any remaining regular payment, which will be applied as an advance regular payment unless specifically designated otherwise.

2. Advance Payments and Additional Principal Payments

The Agency also has established specific procedures for applying advance payments and additional principal payments. Advance regular payments are applied as such only when the loan account is current. The payment effective date will be the due date of the next regular payment that is not fully paid. Extra payments are applied as principal to the last installment to become due under the note. Voluntary additional principal payments will only be credited to the account when all regularly scheduled payments on the

account have been paid. These payments are credited to all principal, as of the payment effective date, and do not affect the payment status of the loan. Any amount paid by the borrower in excess of the amount owed will be refunded to the borrower if the excess amount is over $10.

4.17 PAYING RENTAL ASSISTANCE (RA) *[7 CFR 3560.256]*

The Agency pays RA to the borrower based on monthly documentation submitted by the borrower.

An RA payment request is based on actual occupancy as of the first day of the month. In order to receive RA, borrowers must submit to the Servicing Office on a monthly basis *Form RD 3560-29,* and any new tenant certification *Form RD 3560-8, Tenant Certification,* for new tenants receiving rental assistance. Both forms must be prepared for each project according to the instructions on the forms.

Borrower requests for RA payments must be based on the difference between basic rent plus utility allowances for each rental unit eligible for RA and the net tenant contribution of the tenant occupying the RA-eligible unit.

When *Form RD 3560-8* is received, the Loan Servicer will:

- Date stamp the form with the received date.
- Review *Form RD 3560-8,* and verify that the information contained on the form is complete and correctly computed based on information contained in the form.

When *Form RD 3560-29* is received, the Loan Servicer will:

- Date stamp, review, and ensure that entries on *Form RD 3560-29* are supported by the current *Form RD 3560-8*.
- Enter the payment data using Field Office terminals.
- Verify the accuracy of the borrower's servicing address shown on the Finance Office record. When the address shown is incorrect, corrections must be made on AMAS screen M5A, "Record Borrower/Project Data," using a Field Office terminal.

In calculating the RA payment due on *Form RD 3560-29*, the borrower will deduct from the amount due the balance of scheduled loan payments any delinquent payments and other charges and submit any remaining balance to the Field Office by check. If the RA due the borrower exceeds the balance of scheduled loan payments, delinquent payments, and other charges, no additional payment is due from the borrower and an RA check for the excess will be issued by the Finance Office. See examples on following page.

Examples

Example 1: Borrower Olson shows on *Form RD 3560-29* for the month of May a loan payment due to the Agency of $1,865 and RA due from the Agency of $3,600. The Finance Office sends Olson a check for $1,735.

Example 2: Borrower Johnson shows on *Form RD 3560-29* for the month of May a loan payment of $2,200 due to the Agency and RA of $1,200 due from the Agency. Johnson must attach a check made out to the Agency in the amount of $1,000.

4.18 SPECIAL CIRCUMSTANCES

A. Reapplication of Payments

Loan Servicers may approve, with the authorization of the State Director, reapplication of payments between accounts when payments have been applied in error. However, no change may be made if the loan is paid in full, the canceled note or notes have been returned to the borrower, and the security instruments have been satisfied. The AMAS Coordinator will enter changes through Field Office terminals.

B. Overpayments and Refunds

Loan Servicers will process overpayments and refunds to borrowers according to the procedures outlined in 7 CFR 3560.401 through 7 CFR 3560.404, Account Servicing Policies.

C. Recoverable and Nonrecoverable Cost Items

The Loan Servicer will service recoverable and nonrecoverable cost items according to the procedures outlined in 7 CFR 3560.403 and RD Instruction 2024-A.

SECTION 4: ACCOUNT TRACKING AND SERVICING

4.19 OVERVIEW

The Agency must track borrower accounts to ensure that all payments are up-to-date and to identify any problems that could lead to delinquencies or defaults. Any transaction that affects an account must be tracked to ensure that it has been processed correctly and that it has not had a negative impact on the interests of the borrower, tenants, or the Government.

The Agency has sought to facilitate and standardize the account tracking process by requiring that all new loans, and many existing loans, be closed and serviced using PASS.

4.20 ACCOUNT TRACKING PROCEDURES

A. Conditions for Conversion from DIAS to PASS

Conversion of accounts from DIAS to PASS may be either voluntary or involuntary. If a borrower requests voluntary conversion of an account, Loan Servicers need to determine that all accounts are current, and that the conversion will not result in rents that exceed Conventional Rents For Comparable Units (CRCU). An involuntary conversion may occur at the time of a servicing action such as a subsequent loan, transfer, or reamortization (so long as CRCU are not exceeded). In such cases, the Servicing Office completes *Form RD 3560-50, Conversion Agreement,* and submits it to the State AMAS Coordinator for entry into AMAS. The terms for the converted loan will be the same as for the original loan.

B. Procedures for Conversion from DIAS to PASS

The following actions must be taken to convert an account from DIAS to PASS:

- The Loan Servicer will complete *Form RD 3560-50,* except for loans converted on *Form RD 3560-21, Assumption Agreement,* or *Form RD 3560-16, Reamortization Agreement* (which converts the account to PASS);

- When the borrower will continue to receive interest credit following conversion, the current interest credit plan type will be passed through to the PASS loan. A new *Form RD 3560-9, Interest Credit and Rental Assistance Agreement,* must be prepared by the borrower and the Loan Servicer to reflect the PASS payment and subsidy amount;

- The Loan Servicer will document on the back of the original note or assumption agreement that the payment schedule was modified; and

- The Loan Servicer will establish principal balance converted to PASS according to the FMI for *Forms RD 3560-21* or *3560-16,* and specific requirements based on whether the transaction is on the same terms or new terms.

C. Account Reviews

The foundation for proper and timely debt payment is sound budgeting and monthly review of income and expenses by the borrower and, as necessary, by Loan Servicers. Account maintenance must begin with initial planning and must be an integral part of ongoing analysis, planning, and follow-up management assistance.

Loan Servicers must review each loan account at least monthly by accessing AMAS and carefully reviewing the status screens showing account status and other relevant account information. Accounts that are 30 days past due are subject to special servicing actions, as outlined in Paragraph 4.21 and in Chapter 10 of this handbook.

4.21 SERVICING ACCOUNTS THAT ARE 30 DAYS PAST DUE

When tracking borrowers' accounts, Loan Servicers must identify all accounts that are 30 days past due. The Loan Servicer will service these delinquent accounts according to the procedures in this handbook, with guidance and assistance as necessary from the State Director. If a borrower's delinquency is not corrected by the time the account is 60 days past due, the Agency initiates legal action to cure the borrower's default. In such cases, Loan Servicers will follow the procedures described in Chapter 10 and any additional procedures established by the State Director for the particular type of loan.

4.22 SPECIAL CIRCUMSTANCES

A. Same Terms Transfers

Same terms transfers, when the transferor has been converted to PASS, must take place in a current loan status on the date of the transfer. Borrowers must bring current any delinquent principal and interest before the conversion can occur.

B. Overpayments and Advance Regular Payments

Overpayments and advance regular payments made on PASS accounts result in the creation of a "future paid" status account under AMAS. Loan Servicers must reverse and apply such advance payments to the transferor's principal balance prior to determining the loan balance to be transferred. If the future payments have been made through RA, they must be refunded to the transferor and reapplied in the form of cash on the loan balance.

SECTION 5: FINAL LOAN PAYMENT *[7 CFR 3560.404]*

4.23 OVERVIEW

Because the final payment on an Agency loan signifies the end of the borrower—Agency relationship and opens a number of legal questions, it is important that the Agency has specific requirements and procedures for accepting and processing final loan payments. The Agency's procedures ensure that payments are received in the proper amount and suitable form, that security instruments are released only when all obligations are satisfied, and that special circumstances are handled appropriately.

Before the Loan Servicer begins the final loan payment process, they must determine if the final loan payment is a prepayment, as covered in Chapter 15. If the final payment is an advanced payment of the account, the borrower must complete the prepayment process as outlined in 7 CFR part 3560, subpart N, and Chapter 15 of this handbook before the Agency will process a final loan payment.

4.24 PROCESSING FINAL LOAN PAYMENTS

There are a number of steps that Loan Servicers must follow when accepting and processing a final loan payment.

A. Payment Amount Determined

Loan Servicers will obtain and provide to the borrower the amount to be collected for payment in full of all loans by accessing the relevant AMAS status inquiry screens on the Field Office terminal. Loan Servicers will furnish requests for payoff balances on all accounts in writing. Such requests require verification of the payoff amount by two employees in the Field Office.

B. Funds Shifted from Supervised Bank Account

When a borrower is ready to pay a loan in full, Loan Servicers must withdraw any funds remaining in the supervised bank account for the initial loan and remit this amount for application to the borrower's account. *Note:* This requirement does not include the supervised bank account for reserves. Any amount remaining in the reserve account above the required level and unused is the borrower's money and may be released to the borrower following receipt of the initial payment.

C. Forms Processed

When the Field Office receives final payment, the Loan Servicer processes it in AMAS as a paid-in-full payment. The payment must be loan specific.

D. Payments Applied

Loan Servicers apply final payments on the next payment due date or the final due date shown on *Form RD 3560-52,* assumption agreement, or reamortization agreement, whichever is sooner.

E. Security Documents Released

1. General

When the Finance Office verifies that all amounts owed to the Government have been paid in full, or a compromise or adjusted agreement has been accepted and approved by the appropriate official, it will release security documents to the borrower, along with *Form RD 140-4, Transmittal of Documents*.

If the Agency receives final payment in cash, U.S. Treasury check, cashier's check, certified check, money order, or bank draft, Loan Servicers will give the security documents to the borrower at the time of final payment. If not, the Agency will release the documents after a 30-day waiting period.

2. Loans Secured by Both Real Estate and Chattels

If a loan secured by both real estate and chattels is paid in full, the chattel security instrument will be satisfied or released by the Loan Servicer in accordance with RD Instruction 1962-A.

3. Loans Where Mortgagee Is Required to Record or File a Satisfaction

If State law requires the mortgagee to record or file a satisfaction, the Agency will do so consistent with the State supplement. The Agency will deliver the form of satisfaction to the borrower for recordation at the borrower's expense.

4. Loans to Insured Borrowers Whose Note and Security Instrument Are Held by a Lender

For an insured borrower whose note and security instrument are held by a lender, the Loan Servicer will deliver to the borrower the note and other documents upon receipt from the lender of *Form RD 3560-52,* marked "paid in full," the original security instrument, and the instruments of satisfaction or release.

F. Release of Interest in Insurance

When the borrower's loan has been paid in full and the satisfaction or release of the mortgage has been executed, the Loan Servicer is authorized to release the mortgagee interest in the insurance policy as provided in Chapter 3 of HB-2-3560.

G. Special Circumstances

1. Refunded Principal

If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of the receipt of the refund.

2. Overpayment

If the borrower's final loan payment is greater than the amount due to close the loan, the Agency will process a refund to the borrower 30 days after receipt of the final payment.

3. Agency Error in Handling Final Payments

If the Agency makes an error in handling final payments and the error results in an account balance, the Loan Servicer may attempt to collect that amount from the borrower.

4. Note-Only Cases

When a loan is evidenced only by a note (i.e., no security instruments are evident) and the note is paid in full, the Agency will deliver the note to the borrower.

5. Other Situations

If a situation develops that is not covered by regulations, the Loan Servicer forwards the borrower's case file to the State Director, who may offer assistance and special instructions after consultation with the Office of General Counsel (OGC).

H. State Supplements

The State Director, with the advice of OGC, will issue a State supplement and the necessary forms for releasing or satisfying real estate security instruments. Any unusual cases that are not covered by the State supplement will be handled in accordance with advice from OGC.

I. Redelegation of Authority

Field Office Directors are authorized to redelegate to Field Office Staff the authority to execute releases and satisfactions associated with final payments, provided it is determined that the individual to whom such authority is being redelegated has had sufficient training and experience to properly exercise such authority.

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CHAPTER 5: OWNERSHIP AND ORGANIZATION CHANGES *[7 CFR 3560.405]*

5.1 INTRODUCTION

During the term of an Agency loan, changing circumstances may lead borrowers to seek Agency approval of a change in the structure of the ownership entity. For instance, partnerships may dissolve, or substitute individuals or entities may obtain an ownership interest in a property due to business reorganizations, retirements, or other reasons. To address these situations, the Agency has developed requirements and procedures for receiving notification of and reviewing proposed changes, as well as granting approval for such changes to ensure that the Agency's security interest is protected.

This chapter covers the Agency's requirements regarding changes in a borrower's ownership structure and Agency procedures for reviewing and accepting such changes.

5.2 OVERVIEW OF CHANGES REQUIRING PRIOR AGENCY CONSENT

The Agency imposes specific requirements on certain proposed changes in the structure of the borrower entity to ensure the adequacy of the new or substitute interests and thus protect the interests of tenants and the Government.

The Agency requires that borrowers obtain prior Agency consent to organizational changes involving the controlling interests of the borrower entity to ensure that such changes will continue to serve the needs of tenants and protect the interest of the Government. For example, if one partner in a borrower entity decides to sell their interest to a new individual from outside the existing organizational structure, the Agency needs to review that individual's prior history and qualifications to ensure that the person is eligible to participate in the program (i.e., is not under suspension, debarred, under Office of the Inspector General (OIG) review, or known to be in default on any Agency loan[s]). The purpose of this review is to evaluate that the borrower entity will continue to be eligible under program requirements and that any changes in the organizational structure do not adversely affect the Agency's security interests.

5.3 REQUIREMENTS FOR OBTAINING AGENCY CONSENT

A. Overview

Certain changes in the structure and ownership interests in the borrower entity require Agency consent before they become effective. These include:

- Any changes in the controlling interests of the borrower entity;
- Changes in the ownership interests of the borrower entity that involve the transfer of stock to any individual or organization not previously listed in the ownership documents submitted to the Agency; or

- A 100 percent change in membership interest where the tax ID remains the same and the organizational entity remains the same during any 12-month period.

Examples of such changes include changes in general partners, addition of new general partners, proprietorship as a result of death, divorce, or other applicable ownership changes.

B. Written Request

Requests for Agency consent to organizational changes must be submitted in writing, along with *Form RD 3560-1, Application for Partial Release, Subordination, or Consent*, to the Servicing Office. Each request must describe the proposed changes in the organizational structure of the borrower entity and provide the information shown in Exhibit 5-1 for each new or substitute ownership interest or member in the borrower entity.

The information included with the written request must demonstrate that the proposed change will not adversely affect the Agency's security interest in the property by illustrating that all key individuals would meet loan approval requirements.

Exhibit 5-1

Required Content of Requests for Agency Consent to Changes in Borrower Entity

- *Form RD 3560-1, Application for Partial Release, Subordination, or Consent;*
- The names, addresses, and taxpayer identification numbers of individuals with controlling interests in the new or substitute entity;
- Certification that the new interests and/or members are not suspended, debarred, or in default on Agency loan(s);
- The organizational role of the new interest/member or changes in roles of existing individuals;
- Résumé, including experience managing real estate, business experience, and education;
- Identity-of-interest (*Forms RD 3560-30, Certification of No Identity of Interest (IOI), and 3560-31, Identity of Interest Disclosure/Qualification Certificate*);
- Personal financial statement;
- Percentage of ownership of the new interest/members in the borrower entity;
- Proposed amendments to organizational documents;
- Previous participation certification;
- Opinion of the borrower's attorney stating that the changes are in accordance with reapproved organizational documents, are permitted by law, and comply with Agency regulations; and
- Credit report fee, if applicable.

C. Assumption of All Applicable Responsibilities by New Interests

If any portion of the controlling interest in the borrower entity is transferred to an individual or organization not previously holding a controlling interest, the new individual or organization must agree to assume the responsibilities and obligations established under the terms of the *Form RD 3560-52, Promissory Note* with the Agency, the mortgage, the loan agreement/resolution, and any applicable partnership documents for the entity.

D. Assumption of Liability by Substitute General Partner

In the case of substitution of any general partner, the substitute general partner must agree to assume the responsibilities and obligations of the original general partner under the terms of the Agency *Form RD 3560-52*, mortgage, and the borrower's partnership agreement.

In consultation with the Office of General Counsel (OGC), the State Director may require the substitute partner to sign an agreement to assume all applicable responsibilities. This agreement is placed in the case file.

E. Satisfaction of Eligibility Requirements

All proposed new individuals in the ownership entity must meet applicable eligibility requirements for borrowers under 7 CFR 3560.55. For further information on eligibility requirements, see Chapter 4 of HB-1-3560.

5.4 BORROWER REQUESTS FOR CONSENT

Borrowers must submit their written requests for Agency consent to organizational changes at least 45 days prior to the desired effective date of the change. Borrower requests must contain the information listed in Exhibit 5-1.

5.5 AGENCY REVIEW OF BORROWER REQUESTS

A. Overview

To ensure that all changes to borrower entities protect the interests of tenants and the Government, the Agency has developed procedures for review and approval of proposed changes. By preventing changes that do not further program objectives, the review process ensures that program implementation is consistent with Agency mandates.

Loan Servicers need to take all actions necessary to determine that the changes will have no adverse impact on the loan or property. These actions will vary based on the nature of the changes to the borrower entity.

The Agency may reject such requests if the borrower fails to adequately demonstrate that the proposed change will not adversely affect the interests of the Agency or the tenants of the property.

B. Loan Servicer and State Director Actions

Loan Servicers first review borrower submissions for completeness. Next, they perform a review to determine whether the new individuals or organizations proposed meet eligibility criteria (i.e., the same criteria required to qualify for a new Agency loan as set forth in the HB-1-3560). To determine that approval of the transaction will not adversely affect the objectives of the loan or the property, the State Director must consider past performance, experience, qualifications, and abilities of any individual or organization obtaining an interest in the borrower organization. Finally, Loan Servicers review all documentation to determine if the substitute general partners propose to assume all liability that had been assumed by the withdrawing entity.

When the initial review has been completed, Loan Servicers process and submit *Form RD 3560-1* to the State Director, who either approves or rejects the proposed transfers or changes. In cases where proposed membership changes are not covered in the organizational documents or appear to be in conflict with applicable regulatory requirements, Loan Servicers may submit case files to OGC for review and concurrence regarding a borrower's legal sufficiency to assume the proposed role in the new organization. OGC does not override the decisions made by Loan Servicers with regard to organizational changes.

5.6 DOCUMENTATION OF CHANGES

To ensure that there is a running history of all changes made to the organization of a borrower entity, the Agency requires that all changes be adequately documented through both written notification to borrowers and maintenance of case files. Loan Servicers must respond to all requests for Agency consent to changes in a formal letter, a copy of which is placed in the borrower's case file. Documentation allows the Agency to track the legality of the changes and the suitability of any new individuals or organizations added to the borrower entity over time. All changes must be entered into the MFIS so that the automated system is always up to date.

CHAPTER 6: DETERMINATION OF PROJECT SUITABILITY

6.1 INTRODUCTION

When there are loan repayment or compliance problems with a project and the Agency is considering special servicing actions, or prior to making a subsequent loan, the Loan Servicer must determine that the project remains suitable as a program property. To remain a suitable project, there must be a need for the project and the physical property cannot be obsolete. If a project is suitable, it is in the best interest of the Government to proceed with the servicing action. However, if the Agency determines that a project is no longer suitable, the Agency may designate it as non-program rather than spend limited Agency resources on a project that does not fulfill the goals of the program.

This chapter is designed to assist the Agency, and the Loan Servicer in particular, to make an analysis of a project's suitability and make a determination that meets the principles and objectives of the Agency. This chapter also provides guidance on implementing appropriate actions when a project is no longer suitable:

6.2 WHEN TO CONSIDER SUITABILITY

The Loan Servicer should conduct a suitability analysis when the borrower and project meet one of the following conditions.

- When there are loan repayment or compliance problems with a property and the Agency is considering special servicing, including a transfer or liquidation action; or

- When the borrower requests a subsequent loan.

There are exceptions to the conditions above that do not require the Loan Servicer to consider suitability.

- When a project is clearly suitable and there are no loan repayment or compliance issues that threaten the financial viability of the project, a suitability analysis is not necessary. For example, if the Loan Servicer is processing a limited review transfer, in accordance with Chapter 7, or the Loan Servicer has determined that there are no compliance violations or increased risks to the Agency, then there are clearly no suitability issues that require further analysis.

- When a borrower requests to prepay a loan the Agency should not conduct a suitability analysis. In this case, the Loan Servicer must proceed with the borrower in accordance with Chapter 15.

- When a case has been referred to the Office of General Counsel (OGC) or the U.S. Attorney for action, the Agency may not consider suitability. The Agency does not pursue actions separate from the legal actions of OGC or the U.S. Attorney.

6.3 KEY STEPS TO COMPLETING A SUITABILITY REVIEW

The Agency completes five major steps to move through the process of making a suitability determination and implementing the appropriate actions based on the analysis. The Loan Servicer has primary responsibility for the first three steps of conducting the analysis of need and obsolescence. If the initial analysis indicates that the property may not be suitable, the State Office, with assistance from OGC and the National Office as necessary, is responsible for the next two steps, in which a final determination of suitability is made and the resulting course of action is approved. These steps are listed in Exhibit 6-1.

Exhibit 6-1

Key Steps to Complete a Suitability Review

1. Analysis of ownership
2. Determination of need
   - A. Information gathering
   - B. Analysis
     - i. Impact on tenants
     - ii. Economic viability
     - iii. Impact on the community
   - C. Determination
3. Determination of obsolescence
   - A. Information gathering
   - B. Analysis
     - i. Health and safety
     - ii. Physical characteristics
     - iii. Need
   - C. Determination
4. Determination of suitability
5. Implementation of the suitability determination

If the primary suitability issue concerns obsolescence, the Loan Servicer must consider need to determine the impact on tenants. The amount of information and analysis needed to complete each step may be different. The appropriate type of review depends on the level of documentation the Agency has on file and the level of analysis required to make a final determination.

6.4 ANALYSIS OF OWNERSHIP

The analysis of project suitability must first consider the ownership of the property to confirm that it is acceptable. Key questions to answer include:

- Is the present ownership entity still legally operational?

- Is the ownership entity cooperative? (Is the ownership entity responsive to Agency requests for information and does it take action when the Agency identifies issues and deficiencies?)

- Is the ownership entity financially solvent?

- Is competent management being provided?

The answer to all four questions should be yes. If not, improvements must be made for a project to be deemed suitable.

6.5 DETERMINATION OF NEED

To make a determination of need, the Loan Servicer goes through a process of information gathering and analysis before making a determination of need.

A. Information gathering

The Loan Servicer should have the following information to determine need:

- The Agency should obtain a market study. If the Agency has a market study covering the project area that is less than 12 months old, the Loan Servicer may use this market study and update any information as necessary;

- If not included in the market survey, the Loan Servicer may need to obtain local economic indicators, such as local employment and economic trends to judge the short- and long-term prospects for change;

- The Loan Servicer should have the project's updated budget, including a record of accounts receivable and accounts payable;

- The Loan Servicer may ask the borrower to prepare documentation stating the borrower's intentions for the property and the proposed rents if it becomes a non-program property; and

- The Loan Servicer should also seek community input to get information on the community's interest in retaining the project and the community perception of the need for the project.

B. Analysis

There are two components to the analysis of need, impact and economic viability. The Loan Servicer must consider both components to determine if there is a need for a project.

1. Impact

The Loan Servicer must determine if a non-program designation would have a negative impact on tenants. This analysis is the same impact analysis as conducted in response to a prepayment request. See Chapter 15, paragraph 15.22 of this handbook for a detailed discussion on determining impact. The objective of this analysis is to determine if tenants will lose their units, suffer from rent overburden, or be unable to find comparable housing in the community.

The Loan Servicer should use the market study and proposed non-program rent information to consider the following:

- The tenant's ability to stay in the project. This analysis depends on the proposed use of the project after a non-program designation and conventional rents for comparable units;

- The availability of alternative housing if the proposed use of the project or increase in rents will cause rent overburden. The alternative housing must be comparable in size, amenities, and rent to keep project tenants in the local community; and

- If the project has rental assistance, the Loan Servicer must identify comparable units with rental assistance (RA) or other rental subsidies, such as HUD Section 8.

Exhibit 6-2 provides an overview of the full analysis of impact.

Exhibit 6-2

Analysis of Impact on Tenants

Step 1: Answer the following questions about rents and loss of units.

A. Will a non-program designation result in an increase in tenant payments, and, if so, will this new payment be higher than 30 percent of the current tenants' incomes?

OR

B. Will a non-program designation result in a loss of units?

If the answer to both A and B is no, there is no adverse impact on tenants.
If the answer to either A or B is yes, proceed to Step 2.

Step 2: Answer the following questions about the availability of alternative housing:

C. Are there sufficient comparable vacant units in the market area (as indicated by the market study) for displaced tenants to find alternative housing?

AND

D. Are the tenant payments in these units equal to or less than the greater of their current rent or 30 percent of their income?

If the answer to both C and D is yes, there is no adverse impact on tenants.
If the answer to either C or D is no, there is an adverse impact on tenants.

2. Economic Viability

The Loan Servicer must determine if the project is economically viable. If the property cannot generate sufficient income to pay essential expenses, fund accounts, and make loan payments—despite appropriate loan servicing actions, budgeting, and marketing—the property may no longer be economically viable. Economic viability problems are usually associated with a change in local economic conditions and the inability of the project to maintain a sufficient occupancy rate even with aggressive marketing. For example, if a 20-unit project has a 50 percent vacancy rate and has been steadily losing tenants as the area's population declines due to the closing of a factory, the property may not be economically viable. It may not be in the Agency's interest to spend limited resources on a project that cannot meet the financial requirements of the program. Physical characteristics of a property that impact on viability are considered under obsolescence, but utilize the same basic analysis.

Types of questions to consider regarding economic viability include:

- Has the market changed due to changing demographics or local economic conditions such that there is no longer demand for the units?
- Is there a need for a different bedroom mix than the property has to offer?
- In the case of on-farm Labor Housing, is the operator still farming?
- Have there been significant vacancies that cannot be reduced with aggressive marketing?

To make the determination of economic viability, the Loan Servicer should:

- Determine whether the borrower's budget, rents and marketing plans are appropriate in accordance with Chapters 4 and 7 of HB-2-3560.
- Determine that special servicing, including utilizing all appropriate workout tools in accordance with Chapter 10, and increased rental assistance, if available, will not allow the project to be viable. Any increase in rental assistance must be reasonable and approved in accordance with Chapter 8 of HB-2-3560. If the cost to the Agency of special servicing exceeds replacement costs—for example, a write down plus a subsequent loan is greater than new construction costs—the special servicing is not in the Agency's best interest.
- Determine that, based upon the market study, local economic conditions will not significantly improve in the next one to two years. The market study should identify any known changes in the local economy to assist the Loan Servicer in understanding the short- and medium-term impacts. For example, if a new factory or large business is relocating to the local area, or has announced plans to close, these plans will affect the local economy.

- Determine that the borrower, given occupancy levels and any servicing actions, cannot pay essential expenses, adequately fund accounts, and pay the borrower's monthly loan payment in full.

If the Loan Servicer makes all these determinations, the project is economically unviable.

C. Determination

Based on the analysis concerning the need for the project, the Loan Servicer makes one of the following determinations:

1. If a non-program designation would have an adverse impact on tenants and the project is economically viable, then the project is needed.

2. If a non-program designation would not have an adverse impact on tenants and the project is economically viable, then the project is not needed. However, any resulting outcome of the suitability determination should not provide an undue financial reward to the borrower.

3. If a non-program designation would have an adverse impact on tenants and the project is not economically viable, then the project is not needed. However, the Agency cannot remove the property from the program until the Agency finds affordable and comparable housing for all the tenants.

4. If a non-program designation would not have an adverse impact on tenants and the project is not economically viable, then the project is not needed.

6.6 DETERMINATION OF SITE OR BUILDING OBSOLESCENCE

To make a determination of obsolescence, the Loan Servicer should go through the following process to determine if the property (i.e., the site and the building) poses a health or safety threat, has physical characteristics that cannot be addressed economically, or faces adverse local economic conditions. The Loan Servicer must also consider the issue of need when determining if a project is obsolete. The outcome of the need determination does not affect the result of the obsolescence determination, but it may influence how the Agency implements the result.

A. Information gathering

The type of information the Loan Servicer needs to determine if a property is obsolete depends on the nature of the suitability problem. In most cases, the Loan Servicer will need several of the following:

- Data on environmental conditions. The need for an environmental review, assessment, or due diligence is based on the condition of the property and must be conducted in accordance with RD Instruction 1940-G;

- A physical inspection. The Loan Servicer and State Architect, if appropriate, may conduct a unit-by-unit physical inspection of the property with a cost estimate to fully understand the problem and to determine whether repairs or rehabilitation may resolve the problem;

- Market study. A market study is most appropriate when the problems are related to external factors. It is also necessary as part of the need assessment;

- Cost Estimate. A professional may be needed to determine the feasibility of repairs, and to obtain a cost estimate;

- Cost estimates for new construction in the project's area. New construction cost estimates are critical to determine the Agency's financial interest; and

- Borrower's intentions. The Loan Servicer may ask the borrower to prepare documentation stating the borrower's intentions for the property and the borrower's proposed rents if it is designated non-program.

B. Analysis

There are three reasons a property may be considered obsolete:

- The property poses a health or safety risk to the tenants;

- The building has structural or design characteristics that make the project economically unviable; or

- The site is no longer economically viable because of local economic conditions (such as the transportation infrastructure).

The Loan Servicer must also determine that the problem either cannot be solved through special servicing, workout agreement, or a subsequent loan, or that solving the problem is not in the Agency's best financial interest. Exhibit 6-3 lists helpful questions to use in making this determination.

Exhibit 6-3

Factors Influencing Obsolescence

Site

- Has economic obsolescence adversely affected the community?
- Does the community have adequate medical, transportation, and school systems?
- Is the site itself located in a solid residential neighborhood that is a viable part of the community?
- Does the site have frontage along at least one-fourth of the perimeter?
- Does the topography of the site lend itself to optimal accessibility?
- Does the site have environmental hazards or commercial influences that adversely affect it?

Building

- Is the building structurally sound?
- Are there obsolescence factors that are economically unfeasible to correct such as the building design, poor quality of construction, environmental hazards, or structural deterioration?
- Does a unit-by-unit inspection with cost estimate for rehabilitation, deferred maintenance, and wheelchair accessibility demonstrate that the costs of this work are not feasible in the project budget?
- Can the property be rehabilitated to bring it into compliance with applicable building codes or must an exception to code requirements be obtained from local authorities?
- What is the estimated economic useful life of the property after rehabilitation?

1. Health or Safety

Health or safety issues are most often identified or documented during a physical inspection or environmental assessment of the property. While a majority of violations can be fixed through maintenance, repairs, or even a subsequent loan to pay for rehabilitation, some violations are more difficult to resolve.

Any compliance violation that is identified on the physical inspection report may be classified as a health or safety issue. However, most of these violations will never lead to a concern of suitability. For example, broken windows, a leaking roof, or exposed wiring are all easily corrected if funds are available. Health or safety issues that do affect suitability will likely pertain to the entire project and either cannot be repaired, or repair is too costly. For example, a property with a damaged and unstable foundation due to sand under the property cannot be repaired at all, or repaired without expense beyond what is fiscally responsible.

2. Physical Characteristics

Physical characteristics that make the project obsolete or economically infeasible are usually documented either through a physical inspection or with a market study.

Example

For a project that may need on-site laundry facilities to improve the project's marketability, the borrower may be able to receive a subsequent loan for rehabilitation, if necessary, to resolve the problem; therefore, the property is not obsolete. However, if a factory is built near the property, even if there are no negative health or safety factors, the quality of life will suffer due to an increase in noise, odor, or other factors. Such developments may make it difficult to market the property and cause it to become obsolete in the local market.

3. Local Economic Conditions

Local economic conditions that can affect a project's viability are generally addressed in the market study and generally cannot be fixed through any changes to or investments in the property. For example, if a community lacks sufficient transportation, medical, and school systems or if the local neighborhood has changed in character so that it is no longer a desirable residential site, the project may be rendered obsolete:

4. Need

Before making a final determination on whether the property is obsolete, the Loan Servicer must consider if there is a need for the project. A determination of need does not influence whether the property is obsolete, but it may influence the Agency's response to a finding of obsolescence.

The Loan Servicer determines the need for the project, with an emphasis on determining if a non-program designation will have an adverse impact on tenants, in accordance with Paragraph 6.5.

C. Determination

For health or safety issues, physical characteristics, or economic conditions related to the building or site, the Loan Servicer must document that the condition does exist and one of the following statements is true in order to declare the property obsolete.

1. The issue cannot be resolved through special servicing, workout agreement, or a subsequent loan;

2. The total cost to resolve the issue, including subsequent loans and special servicing, is greater than the cost of building a new project; or

3. The size of the rehabilitation loan, or other financing, makes the project economically unviable.

For example, in the scenario of a property unknowingly built on sand, the physical inspection and core soil sample can confirm the threat to tenants and damage to the property. The Loan Servicer may also need a professional to determine if the problem can be corrected and provide a cost estimate.

If the problem can be resolved, the Loan Servicer must determine the total amount of a subsequent loan plus any increased rental assistance, write-off amount, or other special servicing costs. For example, if the property requires a rehabilitation loan of $1 million, and a debt write-off of $500,000, and the cost of new construction is $1.4 million, it is not in the Agency's financial interest to fund the rehabilitation.

The professional may state that the foundation may be repaired at 60 percent of the cost of new construction. However, if the property currently struggles to make the necessary loan payments, rents are as high as the market and program policies allow, and no rental assistance or other special servicing funds are available, the additional debt may make the project economically unviable.

6.7 DETERMINING IF THE PROPERTY IS SUITABLE

If the Loan Servicer determines that there is no need for the project and/or the project is obsolete, the Loan Servicer should prepare the case file with all the documentation from the suitability analysis with a recommendation and forward the analysis and recommendation to the State Office. The State Office may seek advice from OGC and the National Office as necessary to determine if it agrees with the Loan Servicer's analysis and recommendation. If the State Office determines that a borrower should be offered prepayment, the State Office must send the case file to the National Office for approval. If the Loan Servicer's analysis indicates that the project is suitable, the Loan Servicer may proceed with the servicing action and does not need to forward the case file to the State Office.

A. Tenant Notification

When the Loan Servicer sends the case file to the State Office, the Loan Servicer should provide written notification to the tenants informing them that the Agency is reviewing the project's suitability. The Agency should hold a meeting with the tenants to explain the implications of a possible non-program designation and explain how the process will proceed. Additional notifications should be provided to tenants when the Agency makes a final determination and, if applicable, when a final date has been set for designating the property as non-program.

B. No Longer Suitable Determination

In making its determination of whether a property is no longer suitable, the State Office should consider how the factors of need and obsolescence influence the Agency's decision. There are four possible outcomes when considering these factors as outlined in Exhibit 6-4:

Exhibit 6-4

Determining if a Property is Suitable

There are four possible combinations of whether there is a need for a property and whether the property is obsolete.

1. If there is a need for the project and the property is not obsolete, the property is suitable.
2. If there is a need for the project and the property is obsolete, then the property is no longer suitable.
3. If there is no need for the project and the property is not obsolete, the property is no longer suitable, and prepayment, with National Office approval, is the preferred outcome.
4. If there is no need for the project and the property is obsolete, the property is no longer suitable.

If the Agency determines that the property is no longer suitable to remain in the program, then the Agency must determine if the property should be designated as a non-program property or a different course of action is more appropriate.

C. Borrower Responsiveness

The State Office should consider what, if any, role the borrower played in creating or perpetuating the need or obsolescence problem. The State Office should also consider borrower responsiveness in trying to overcome suitability problems. A finding that a project is no longer suitable and the resulting decision to designate the property as a non-program property should be used primarily when the suitability problem was not intentionally caused by the borrower and the borrower made a good faith effort to overcome the problem. However, when it is in the Agency's best interest, the Agency may make a non-program designation if the borrower was responsible for or unresponsive to the problem. The Agency should minimize any financial gain such a borrower may receive through a non-program designation.

D. Other Factors

The Agency may determine that even though there is no need for a project or the property can be considered obsolete, it is in the Agency's best interest to keep the property in the program. In most cases, the Agency is making a decision to continue to put resources into the property in order to maintain it as a suitable program property. Such factors that may lead to this decision include when there is a significant negative

impact on a community, which the Agency cannot mitigate without undue expense, or when a non-program determination is not in the Agency's best interest.

E. Take a Different Course of Action

The Agency may determine that if a property is no longer suitable for the program, it is in their interest to take a different course of action, rather than declaring a property as non-program. The Agency may:

- Continue with special servicing actions, including developing a workout agreement in accordance with Chapter 10;
- Request the borrower to transfer the property in accordance with Chapter 7;
- Request the borrower to change the management agent in accordance with Chapter 3 of HB-2-3560; or
- Initiate liquidation in accordance with Chapter 12.

6.8 REGULAR VS. EXPEDITED REVIEW

A. Preliminary Determination

For both the questions of need and obsolescence, the Loan Servicer determines whether to conduct a regular or expedited review. For example, the Loan Servicer may determine that no review of obsolescence is necessary, but feels that a full review of need is required. Another option may be to conduct an expedited review of need and a full review of obsolescence factors. In all cases, the Loan Servicer must consider the impact on the tenants.

B. Regular Review

A regular review is most appropriate when the Loan Servicer does not have sufficient information on the suitability problems to make a determination. A regular review allows the Loan Servicer to obtain the necessary documentation so the Loan Servicer has a full understanding of the suitability issues and can conduct an in-depth analysis to recommend the most appropriate outcome. Among the issues the Loan Servicer must have sufficient documentation on to determine suitability are:

- What is the nature of the suitability problem or issue?
- What would be the impact on tenants if the property were removed from the program?
- Is the suitability problem permanent or short-term?
- Will special servicing resolve the problem?

- What is the availability of resources, such as rental assistance, subsequent loan funds, and owner funds?

- What actions has the borrower taken to resolve the problem?

If the Loan Servicer cannot answer these questions and show supporting documentation in the case file, the Loan Servicer should conduct a regular review.

C. Expedited Review

An expedited review is most appropriate when the Loan Servicer already has significant documentation on the suitability problem and the resolution is readily apparent. For example, if the Agency has documentation that a property was unknowingly built on sand and the damaged foundation is causing a significant health and safety threat to tenants, an expedited review may be appropriate. In this situation, while it may be apparent that the property in no longer suitable, the process of implementing the decision and ensuring that all tenants find alternative housing that is affordable, adequate, and appropriate, may be a difficult and time-consuming process.

To conduct an expedited review, the project should meet the following criteria:

- The Agency has substantial documentation on the project's suitability issues;

- The outcome of the analysis is readily apparent; and

- The cause of the problem and the suitability outcome determination will likely not be disputed.

6.9 CHANGING A PROJECT'S DESIGNATION TO NON-PROGRAM

To implement the determination that a program is no longer suitable, the State Office must act in a manner to protect the Agency and the property's tenants. The basic steps in the process of designating a property as non-program when there is an adverse impact on tenants are the same as when there is no adverse impact. However, when there is an adverse impact, the Agency will need to take additional measures to ensure that all tenants receive decent, safe, and affordable housing. This process of assisting tenants will likely delay the implementation of a non-program designation.

A. Determine Implementation Plan

In making a determination of the most appropriate means to remove a property from the program, the Agency must balance the following interests:

- Act in the financial interest of the Agency by obtaining the greatest net recovery;

- Act to protect the interest of the tenants by ensuring they have decent, safe, and affordable housing; and

- Act to protect the integrity of the program by ensuring that the non-program designation does not provide undue rewards to the borrower.

Based on these interests, the Agency must choose the most appropriate of the following options to remove the property from the program:

- Allow the borrower to prepay the loan in accordance with Chapter 15. The National Office must approve all prepayment agreements;

- Allow the borrower to retain the property as a non-program property and repay the loan on non-program rates and terms;

- Require the borrower to transfer the property as a non-program property, in accordance with Chapter 7; and

- Liquidate the property and sell it as non-program real estate owned (REO) property, if the Agency acquires the property into inventory, in accordance with Chapters 12 and 14.

B. Assist Tenants

Based on the impact of the non-program designation on tenants, the Agency must assist all tenants to find decent, safe, and affordable housing in the area of the project. Even if there should be no adverse impact on tenants, the Agency should work with all tenants to ensure that everyone is properly housed. All tenants must have decent, safe, and affordable housing before the Agency designates a property as a non-program property. The Agency should take the following steps to assist tenants, as necessary.

- Work with other federal, state and local agencies to find alternative housing and subsidies;

- Provide *Handbook Letter 201 (3560), Letter of Priority Entitlement (LOPE)* letters to tenants. If tenants have RA, the RA may be transferred with the tenant to any other eligible project; and

- Provide other assistance and guidance, as appropriate, to assist tenants find alternative housing.

C. Designate the Property as Non-Program

After all tenants are assured of continued decent, safe, and affordable housing, the Agency may complete the chosen means of implementation and designate the property as non-program. The State Office should work with the National Office, OGC, and the St. Louis Office, as necessary, to complete the appropriate transactions.

CHAPTER 7: TRANSFERS OF PROJECT OWNERSHIP *[7 CFR 3560.406]*

7.1 INTRODUCTION

During the term of an Agency loan, borrowers may determine that it is in their best interest to transfer a project to another owner. Changes in a borrower's circumstances or changes in the local market are common factors that may lead a borrower to seek a transfer. The Agency may approve a transfer of ownership of the property if the transferee and the project meet certain criteria, and if the transaction is in the best interest of the Agency and the tenants.

In many ways, transfers are similar to approving a new loan. The Agency must ensure that the transferee meets the same eligibility criteria and has the financial capacity and management experience to be a project borrower. In addition, the Agency must verify that the project and the use of the property continue to meet the program's purpose of providing adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. To protect the Agency's security interests in transfer, the Loan Servicer must perform the same underwriting evaluations that are outlined in Chapters 4 and 5 of HB-1-3560.

However, transfers are also different than approving a new loan. In a transfer, the Agency must also consider the impact on the tenants. While transfers offer an opportunity to improve the quality of housing through improved maintenance, rehabilitation, or better management, a transfer may also increase the risk of loan default or poorer housing conditions unless the Agency carefully evaluates the transfer and the transferee.

This chapter presents the requirements regarding project transfers and Agency procedures for reviewing and approving such actions. For purposes of the chapter, the term "applicant" or "transferee" is used to refer to the entity that wishes to acquire the property and "borrower" or "transferor" refers to the current borrower or the entity transferring the property.

SECTION 1: OVERVIEW

7.2 AGENCY OBJECTIVE

The fundamental question the Loan Servicer should ask when evaluating a transfer request is:

Will the project and the Agency be better, or at least no worse, off as a result of the transfer?

In answering this question, the Loan Servicer tries to ensure that the transfer meets two Agency objectives:

1. Improve or maintain the likelihood of loan repayment; and

2. Improve or maintain the quality of housing for the tenants.

It is essential that the Loan Servicer can justify that the transfer meets both of these conditions without incurring unreasonable costs to the Agency before recommending to the State Office that the transfer be approved. If a transfer is inadequate in meeting one of the objectives, the Loan Servicer should work with the transferee and the borrower to resolve issues of concern.

7.3 KEY ANALYTICAL CONCEPTS

In evaluating all the components of a transfer request, the Loan Servicer should ask and answer several basic questions to determine if the transfer meets the Agency's objectives. Answering these questions will form the analytical foundation for the assessment that would enable the Loan Servicer to identify potential problems or issues so the Agency, the transferee, and the borrower can address these problems or issues before completing the transfer.

Different steps in the transfer process will answer or begin to answer different questions. By the end of the analytical process, the Loan Servicer should be able to answer and document the answers to these questions, which can serve as the basis for making a recommendation to approve a transfer.

A. Eligibility

The same questions and documentation concerning eligibility that a borrower must answer during the Loan Origination process, the transferee, too, must satisfy. These requirements set the basic standards all borrowers and projects must meet to ensure that the Agency provides Government funds in accordance with the program's statutory requirements. The project's eligibility was documented during the loan origination process; however, the Loan Servicer does need to confirm that the project will remain eligible after the transfer.

- Does the transfer meet program eligibility requirements?
- Is the transferee eligible?
- Will the project remain eligible?

B. Feasibility

The questions of feasibility require more in-depth analysis by the Loan Servicer. Feasibility is also a concept used for Loan Origination and is used to gain a better understanding of the transferee and the transferee's plans for the project. The Loan Servicer needs enough information to determine that the transferee and the project can be successful if the transfer is approved.

- Is the transfer feasible?
- Does the transferee demonstrate adequate project management capability?
- Are the property and any proposed repairs in compliance with program requirements?

- Are the financial arrangements, budgets, and rents feasible?

C. Improve or Maintain Risk Levels

These questions build on the concept of feasibility to include a comparison with the existing borrower. Because a transfer involves existing tenants and an existing property, the Agency must go beyond the questions of feasibility to ensure that the tenants and the Agency will not face increased risks due to the transfer.

- Does the transfer improve or do no harm?
- Will the tenants be better or at least no worse off?
- Will the Agency be better, or at least no worse, off?

7.4 DEFINITION OF TRANSFER

The Agency defines transfers to include projects for which 100 percent of the ownership interest in a borrower entity is sold or transferred to new individuals or a new entity within a 12-month period. Thus, a transfer occurs whenever there is a change in a project's ownership through:

- A change in the legal entity, such that the transferee is considered to be a distinct and separate legal entity from the original borrower; or
- The title is transferred to a new owner, and the new owner assumes all liability for the debt.

Borrowers can request to transfer their project to another separate and distinct entity where the members are involved in both the transferring and the assuming entities, as long as the new entity is legally organized, meets applicable Agency requirements as outlined in Section 7.5 and in accordance with Paragraph 7.11.E.

7.5 CONDITIONS WHEN A TRANSFER MAY OCCUR

To ensure that projects continue to further the objectives of the program and that the Agency's security is protected, Agency consent is required for all project transfers *[7 CFR 3560.406 (b)]*.

The Agency will consider transfers only when the transferee documents in their initial written transfer request that at least one of the following conditions are met:

- The transfer is needed to remove a hardship to the current borrower that was caused by circumstances beyond the borrower's control;
- The transfer is a result of a court order requiring the division of security property;
- The transfer is being requested as an alternative to prepayment;

- The transfer will do no harm to the Agency or tenants; or
- Other circumstances exist which make the transfer in the best interest of the Government and the tenants of the project.

If the State Director determines that hardship is present, the transfer may occur without penalty to the borrower. When hardship is not present and the loan is less than five years old, the current borrower is ineligible for further loans for the remainder of the five years, unless a waiver is granted under the Administrator's exception authority. Hardship may result from:

- Illness or death of the borrower;
- Serious financial difficulties beyond a borrower's control that cause the borrower to shut down their business operation; or
- Inability of the borrower to obtain necessary credit on terms that would facilitate refinancing the debt and allow for operation of the project at affordable rents.

Some transfers, made for the purpose of revitalizing or preserving the existing program portfolio, may involve extensive rehabilitation and the commitment of new resources from the Agency and/or third parties. For these revitalization transfers, Loan Servicers must follow the supplemental guidance provided by the National Office for this type of transfer. This guidance will address existing Agency servicing authorities and ways to effectively utilize third party financial resources. This guidance must be followed whenever the Agency seeks to find solutions to extend and enhance the use of any multi-family housing property that continues to serve the affordable housing needs in its community.

7.6 KEY STEPS TO COMPLETING A TRANSFER

The Loan Servicer completes six steps to move through the process of receiving a transfer application, evaluating the offer, and closing the transfer. These steps are listed in Exhibit 7-1.

Exhibit 7-1

Key Steps to Conduct a Transfer

1. Preliminary Assessment
2. Processing Transfer Application and Determining Eligibility
3. Evaluating the Transferee
4. Evaluating the Project
5. Making the Decision
6. Processing and Closing the Transfer

The Loan Servicer must complete all of the steps in Exhibit 7-1 for each transfer; however, the Loan Servicer may find that some steps in the process may be completed more quickly for some borrowers than others. When a transfer involves a transferee with a record as a good borrower and there are no compliance violations or other issues associated with the transfer, the Loan Servicer will be able to move through the transfer process more rapidly. The

Loan Servicer may determine that specific elements of a transfer may allow for a limited review process, while other components call for more in-depth analysis.

This chapter presents the regular transfer review process and does not present a separate limited transfer review process. The Loan Servicer must demonstrate in the case file that the transfer application addresses the issues of eligibility, feasibility, and risk. These will be documented through the same forms, reports and other documents, but the level of supporting information and review in verifying that these documents meet the Agency's objectives may differ.

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SECTION 2: PRELIMINARY ASSESSMENT

Prior to requesting a full transfer application and conducting a regular review, the Agency requires a preliminary assessment of the proposed transfer. The Agency has developed requirements governing the review of initial project transfer requests to:

- Prevent ineligible transfers or applications;
- Identify potential issues or concerns early in the process so they may be adequately addressed;
- Establish a working relationship with the transferee to ensure an efficient review process; and
- Determine whether to pursue a regular or limited transfer review process.

7.7 REQUIRED DOCUMENTATION FOR THE INITIAL TRANSFER REQUEST

Prior to submitting an initial transfer request, either the borrower or transferee will likely contact the Loan Servicer to discuss what documentation is required as part of a transfer. The Loan Servicer should provide the transferee with the list of required documents to submit an initial request (Exhibit 7-2) and should explain that additional information will be required after the preliminary assessment. In addition, the Loan Servicer should explain and provide any documentation necessary to assist the transferee in understanding the Agency's eligibility requirements and the basis on which a transfer application is evaluated.

The initial request to the Agency for a transfer should come from the transferee, although the borrower will probably participate in developing the request by making available relevant information.

Exhibit 7-2

Information/Documents for an Initial Transfer Request

1. A copy of the transfer agreement between the parties, *Form RD 3560-20, Multi-Family Housing Transfer and Assumption Review and Recommendation* which should include the following elements:
   – Description of the transaction (i.e., purchase or sales agreement); and
   – Description of the new entity structure.
2. Identification of any identity-of-interest between the current borrower and the transferee.
3. Description of any other Agency assistance currently or previously received by the transferee, *Form HUD 2530/Form RD 1944-37, Previous Participation Certification.*
4. Financial statement from the parties.
5. Organizational documents.
6. Identification of any additional funds that will be allocated to the project and the planned purpose for the funds.
7. Project operating budgets covering the first year of operation following the transfer or sale.
8. Description of the transferee's experience (i.e., résumé).
9. Identification of all immediate and long-term repair and rehabilitation needs.

7.8 INITIAL AGENCY DETERMINATION

The Loan Servicer will evaluate the transferee's submission to make a preliminary determination whether the transfer can meet the objectives of the Agency. Upon receipt of the initial request, the Loan Servicer should arrange a meeting with the transferee and borrower to discuss the initial application and the transferee's plans for the property in more detail.

A. Application Meeting

The Loan Servicer should meet with the transferee and the borrower after submission of the initial transfer request. The transferee and borrower may choose to hold this meeting after submission of the formal application, but it is recommended that the meeting be held as early in the transfer process as possible. At this meeting the Loan Servicer will discuss the following issues so that the aspiring owner and management agent can demonstrate that they have the background and experience necessary to successfully manage the property:

- The transferee must have the ability and intention to operate the housing project for the purposes for which the original loan was made;
- The transferee must meet Agency eligibility criteria and the Loan Servicer should raise any eligibility issues based on the initial application;
- Whether other credit is available to the borrower or transferee;
- The transferee must show proper organization before transfer of ownership;
- Whether an appraisal is needed;
- Amount of indebtedness to be assumed;
- The transferee's capital needs/development plan;
- Whether the original owner can receive an equity payment;
- The amount of a subsequent loan, if applicable;
- Requirements of existing loan agreements/resolutions and mortgage; and
- Whether the transfer will be on the same terms or new terms.

At this time, the Loan Servicer should inform the transferee that the transferee's initial investment and return on investment will remain the same as what had been provided to the borrower unless:

1. The transferee is a non-profit entity, which is not eligible to receive a return on investment; or

2. The transferee contributes additional funds for repair or rehabilitation, and the Agency agrees to recognize a higher initial investment.

B. Review Eligibility

Prior to the meeting, the Loan Servicer should review the transferee's submission to identify any potential eligibility issues. The Loan Servicer uses the same eligibility requirements as described in Chapter 4 of HB-1-3560. The Loan Servicer should note what additional documentation is needed to verify eligibility when the transferee submits the full application. If any potential problems or eligibility issues are noted, such as a change in project use, the Loan Servicer should raise these concerns with the transferees as soon as possible. Any eligibility issues should be addressed before proceeding to a full application.

C. Consider Feasibility

It will not be possible for the Loan Servicer to make a final determination on the questions of feasibility based on the initial request. However, by reviewing the documents submitted and meeting with the transferee and borrower, the Loan Servicer can begin to assess the feasibility of a transfer. At this initial stage the Loan Servicer should begin considering the following issues:

- Will the transfer fully satisfy the borrower's existing loan or will there be a shortfall? If there may be a shortfall, what are the borrower's intentions to address any outstanding balance?

- Is the transferee planning to make substantial repairs or undertake rehabilitation of the property, and do the transferee's initial plans seem reasonable?

- Does the transfer call for equity distributions to the existing owner?

- Is the transferee going to request a subsequent loan? Does the proposed amount of the subsequent loan seem reasonable and sufficient based on the Loan Servicer's expertise and knowledge of the project?

- Will a writedown be required as part of the transfer? See Chapter 11 for more information on writedowns.

- Are there any other conditions in the transfer agreement or the proposed budget the Agency or the project's tenants may find objectionable?

D. Consider Market Conditions

Depending on the circumstances surrounding the project, the Loan Servicer may want to consider and discuss with the transferee the local market conditions and their potential

impact on the project. If the project is in an area experiencing economic changes, the Loan Servicer should discuss the transferee's thoughts and plans for ensuring that the project remains viable or improves its occupancy rates.

E. Analyze Project Suitability

The Loan Servicer should refer to Chapter 6 to determine if additional analysis is required to verify that there is still a need for the project and the project is not obsolete. If the Loan Servicer determines to further analyze the project's suitability, a full application from the transferee should not be requested until the suitability analysis indicates that the property should remain a program property.

7.9 INITIAL DETERMINATION

A. Decision to Proceed

If the Loan Servicer establishes that there are no eligibility issues identified in the initial application, that the transferee can overcome potential market factors, and that there are no suitability issues, the transferee will be invited to submit a full application for the transfer. If the Loan Servicer identifies issues of concern during the initial review, the Loan Servicer should present these concerns to the transferee and/or borrower. The Loan Servicer should require the issue to be addressed either prior to requesting a full application, or as part of the full application.

B. Regular vs. Limited Review

Based on the preliminary analysis, the Loan Servicer should be able to determine if specific components of the transfer can be completed through a limited review process or if a regular review is needed. A Loan Servicer may be able to use the limited review process:

- For a transferee who is an existing borrower with an approved record-keeping system, the Loan Servicer may only need to have it confirmed that the transferee will use the approved system at the transferred project;

- For a project with no maintenance violations and when the transferee is not proposing any repairs or rehabilitation, the Loan Servicer must still conduct the physical inspection, but there will be no repair and rehabilitation plans to review and approve; and

- If the transferee is not requesting a rent increase, the reserve fund is fully funded, and the project has no violations, the Loan Servicer may not need a market study or need to consider whether rents are within Conventional Rents For Comparable Units (CRCU).

C. Inviting the Complete Application

On determining to invite a formal application for transfer, the Loan Servicer will send a letter to the transferee informing them of the Agency's decisions. The letter to the transferee must include the following information:

- A list of the information that must be submitted to complete the application from Exhibit 7-3; and
- A request that the information be provided within 60 days and at least 45 days prior to the proposed ownership transfer or sale date.

Exhibit 7-3

Information to Be Submitted to Complete Transfer Application

1. Credit report
2. Establishment of citizenship with social security or tax identification number
3. *Form HUD 935.2 Affirmative Fair Housing Marketing Plan*
4. Management plan
5. Management profile*
6. Management certification*
7. Evidence of insurance coverage*
8. Transferee attorney's opinion regarding legal sufficiency and compliance of lease with State/local laws, ordinances and Agency regulations*
9. Narrative statement of proposed record-keeping system*
10. Assurance agreement
11. Letter from transferee's attorney as to legal sufficiency of organizational documents*
12. Current preliminary title report
13. *Form RD 440-34 Option to Purchase Real Estate Property* or other forms of purchase agreement
14. *Form RD 400-1 Equal Opportunity Agreement*
15. Identification of all immediate and long-term repair and rehabilitation needs.
16 Cost estimate and statement of work (specifications) if rehabilitation required *Form RD 1924-13 Estimate and Certificate of Actual Cost*, and
17. Written description from transferee regarding physical condition of the property

* When conducting a limited review, these items may already be on file and may only need reverification or updating, as deemed appropriate by the Loan Servicer.

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SECTION 3: PROCESSING TRANSFER APPLICATION AND DETERMINING ELIGIBILITY

7.10 RECEIVING A COMPLETE APPLICATION *[7 CFR 3560.406(c) and (d)]*

For the application to be considered complete and therefore eligible for further review, the application must include all of the information listed in Exhibit 7-3 and all the information requested in the letter to the transferees inviting them to submit a formal application. The Loan Servicer must inform the transferee promptly if the application is incomplete, and give the transferee a 15-day deadline to furnish the missing information. Once the application is complete, the Loan Servicer will conduct the evaluation of the transfer request within 30 days.

7.11 DETERMINE TRANSFEREE ELIGIBILITY

The Loan Servicer will evaluate the transferee's eligibility based on the items submitted as part of the initial request and the completed application. The Agency's evaluation will verify that the transferee and the property satisfy the general eligibility, identify-of-interest, legal capability, and insurance requirements. If there are any deficiencies, the transferee and borrower must develop a plan, approved by the Agency, before the Agency will consider approving the transfer.

The Loan Servicer must verify the transferee's and the project's eligibility before the Agency can approve the transfer. The Loan Servicer should refer to HB-1-3560, Chapters 4 and Chapter 5, for detailed information on verifying eligibility.

A. Citizenship Requirements

Refer to HB-1-3560, Paragraph 4.16 A for a detailed discussion on establishing citizenship.

B. Organizational Requirements

Refer to HB-1-3560, Paragraph 4.16 B for a detailed discussion on reviewing organizational documents and for specific requirements for limited partnerships, nonprofit organizations, and limited liability corporations.

C. Legal Capability

The Loan Servicer must make a determination of the transferee's legal capability to successfully assume and operate the project for the life of the Agency loan. This determination will be based on the attorney's letter and organizational documents submitted as part of the application. The Loan Servicer should obtain the Office of General Counsel (OGC) concurrence as needed to make such a determination. If there are any deficiencies, the transferee must take appropriate corrective action.

D. Requirements for Existing Borrowers

If the transferee is an existing borrower, refer to HB-1-3560, Paragraph 4.16 D, for a detailed discussion on further eligibility requirements for existing or previous borrowers. The transferee must:

- Be in compliance with all program requirements, or have been in compliance with an approved workout agreement for a minimum of six months for all other projects owned by members of the assuming entity;

- Have documented evidence that the conditions that resulted in the workout agreement were beyond the borrower's control and were not due to inappropriate actions by the borrower; and

- Be free of any adverse audit or investigation findings conducted by the Office of the Inspector General (OIG), with any audit or investigation closed or disposed of to the satisfaction of OIG. If there is an open audit or an investigation is underway, the Loan Servicer will contact OIG to determine if there are potential eligibility issues that may affect the transfer.

E. Identity-of-Interest

During the preliminary assessment the Loan Servicer should have determined if the transfer involves an identity-of-interest. Loan Servicers must not approve identity-of-interest transfers until the State Office can certify that the following conditions are met:

- The account is current;

- The reserve account is on schedule, less any authorized withdrawals;

- The taxes and insurance account is on schedule, and all outstanding bills are paid;

- The tenant security deposit account is fully funded;

- All unacceptable maintenance items outstanding have been completed;

- Management is satisfactory and there is an approved management plan and management agreement, if applicable; and

- The transferee is in compliance with equal opportunity and fair housing requirements.

Completion of this step ensures that identity-of-interest transferees receive appropriate Agency assistance in restoring security properties to compliance through transfers.

F. Insurance

The Loan Servicer must review the evidence of insurance coverage submitted in the

application to verify that the transferee has obtained all required types of coverage and in the proper amounts. If there is any deficiency, the tranferee must be required to take appropriate corrective action.

Completion of this step ensures that the Agency's security properties will be protected from all damage and loss following transfers.

G. Site Control

The transferee's documentation must show control of the land. Control can be in the form of a deed (ownership), an option to purchase from the borrower, or purchase contract. Refer to HB-1-3560, Paragraph 4.12 F, for detailed information on verifying site control.

7.12 PROJECT ELIGIBILITY

The Loan Servicer should refer to HB-1-3560, Paragraphs 4.17 and 5.8 for detailed information on verifying project eligibility. The major components of project eligibility were verified during the loan origination and are not affected by a transfer. However, the Loan Servicer should take the necessary steps to ensure that the project remains an eligible property.

The Loan Servicer must review the transferee's certification that the project will continue to be used to advance program goals and objectives (i.e., providing housing for low- and moderate-income tenants) and, if necessary, a restrictive-use agreement *[7 CFR 3560.406 (g)]*. The Loan Servicer must document in writing that the site is residential in character and the property location enhances the value of the asset. If there are any questions or deficiencies, the Loan Servicer must instruct the transferee to provide the needed clarification.

Completion of this step ensures that properties will continue to advance Agency objectives following transfers.

7.13 NON-PROGRAM TRANSFERS *[7 CFR 3560.406 (l)]*

Housing projects may be transferred or sold to entities that do not meet borrower eligibility requirements for the type of loans being assumed. However, such a transfer or sale will only be considered when it is determined by the Agency to be in the best interest of the Federal Government and the objectives of the original loan can no longer be met. The following special rates, terms, and conditions will apply to such situations:

- The transferee makes a down payment of at least 10 percent of the remaining loan balance to be assumed;

- The transferee has the ability to pay the Agency debt; and

- Monthly or annual installments will be amortized over the term of the loan and the interest rate will be at a rate of interest at least one percent higher than the interest rate offered to eligible borrowers.

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SECTION 4: EVALUATING THE TRANSFEREE

After the Loan Servicer has established that the transferee is eligible, the Loan Servicer must determine if the transferee has the financial and management capacity to successfully operate the project. For a transferee that is an existing borrower with a record of few, if any, compliance violations and missed payments, the eligibility verification process will answer many of the questions about the transferee's capacity. However, for new borrowers, or those with limited experience with the program, the evaluation of the transferee is critical to determine that the transferee has the necessary financial capacity, and management skills and experience to operate a property successfully.

7.14 FINANCIAL REQUIREMENTS

Refer to HB-1-3560, Paragraph 4.18 C, for a detailed discussion on reviewing the transferee's financial capability. The credit report and financial statement are the two primary documents the Loan Servicer uses to determine financial capacity. As part of this financial review, the Loan Servicer must verify that:

- The transferee possesses the financial capacity to carry out the obligations required for the loan;
- The transferee is unable to obtain sufficient credit elsewhere at rates that would allow for project rents within the payment ability of eligible residents, if applying for a subsequent loan; and
- The partnership has the financial ability to meet the program's requirements.

7.15 MANAGEMENT CAPACITY

The transferee must demonstrate that they will provide professional management to ensure successful operation of the project. The Loan Servicer should refer to HB-1-3560, Paragraph 5.9 E, for guidance on analyzing overall management capacity, or Chapter 3 of HB-2-3560 for detailed information on analyzing the management profile, the management plan, and the management certification.

7.16 ANALYSIS

In reviewing and evaluating the transferee's financial capability and property management experience if the Loan Servicer identifies any problems or issues of concern, the Loan Servicer should request the transferee to respond to the problem or concern. The transferee's response must be sufficient for the Loan Servicer to determine that the property will be managed in accordance with program standards, and the transferee can meet all financial responsibilities.

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SECTION 5: EVALUATING THE PROJECT

7.17 PROJECT COMPLIANCE AND FINANCIAL FEASIBILITY

Two key elements of the Loan Servicer's review are to determine that (1) the project is, or will be, in compliance with program requirements and (2) the financial aspects of the transfer are feasible after the transfer. This issue of compliance applies to the physical property and feasibility to the financial components of the project, including budgets, rents, and loan structure. The level of review and key analytical questions the Loan Servicer should focus upon will vary from transfer to transfer and will depend on the existence of compliance issues, necessary repairs, and rehabilitation, or whether a subsequent loan is being requested. After the existing conditions of the property and the transferee's plans for resolving any issues and financing the project are understood, the Loan Servicer must determine if the project will be feasible and meets the objectives of the program.

7.18 PHYSICAL INSPECTION

The transferee's application should include a detailed plan outlining the transferee's repair and rehabilitation plans and their expected costs based on an identification of all immediate and long-term repair and rehabilitation needs. The Loan Servicer will make an on-site inspection of each vacant unit and 10 percent of the remaining units in the project being transferred. When substantial rehabilitation issues are involved, the Loan Servicer will inspect all units. The State Architect and Civil Rights Coordinator are encouraged to participate in the on-site inspections. The inspection is to ensure that the transferee's plans are adequate to ensure that the Agency's decent, safe, and sanitary criteria are met. The inspection will also help the Agency assess compliance with applicable civil rights, disability, and environmental requirements. The Loan Servicer will conduct a compliance review if one had not been completed in the past 12 months prior to the physical inspection. Pictures of any deficiencies will be made part of the applicant's file.

A. Finalize Detailed Repair and Rehabilitation Plans and Costs *[7 CFR 3560.406 (d)(7)]*

The Agency and the transferee must agree to and document all necessary repairs to make the housing decent, safe, and sanitary. If all needed repairs cannot be made prior to the transfer, the funds needed for the repairs will be escrowed and a plan for such repairs developed. The plan will identify each repair, the time frame for completion, an estimate of costs for each item, who will do the work, and any identity-of-interest between the transferee and the parties doing the work or providing materials or services. The Agency must concur with the plan as part of the approval of the transfer.

If the transferee is proposing to rehabilitate either some or all of the units in the project, the Agency and the transferee must agree on the rehabilitation plan, time lines, an estimate of costs for each item, who will do the work, and any identity-of-interest between the transferee and the parties doing the work or providing materials or services. If any tenants will be temporarily relocated during the rehabilitation, the transferee must have a detailed plan, acceptable to the Agency, for providing housing and services to

these tenants. The Agency must concur with the plan as part of the approval of the transfer.

The level of review and documentation of a transferee's repair and rehabilitation plans must be adequate based on the level of repairs and rehabilitation required for the property. The objectives of the analysis are to ensure that the property is in full compliance with program requirements, the plans meet the best interest of the tenants, and the transferee has the financial and management capacity to fulfill the plans.

Improvements or repairs are paid from the following sources listed in Exhibit 7-4.

The Agency will review the reserve requirements for the housing project and may adjust them, if necessary, to adequately cover the cost of addressing the project's capital needs. If current level of reserve contributions are inadequate to meet the property's capital needs, Loan Servicers must follow the supplemental guidance provided by the National Office for procedures in reviewing these cases and determining the amount of any change in the reserve contribution while ensuring the continued feasibility of the project.

Exhibit 7-4

Funding Sources for Repairs

- Transferee's cash contribution;
- Syndication proceeds (as negotiated);
- Reserve amount being transferred (if the amount remaining will be adequate to meet near-term repair and expense needs);
- Transferor funds;
- Third-party funding sources;
- Junior liens;
- Subordination; and
- Agency loan funds (as a last resort and only to the extent needed for essential repairs to ensure that the housing is decent, safe, and sanitary).

B. Civil Rights and Disability Compliance

The Civil Rights Coordinator, or designee, will conduct a civil rights and disability compliance review, provided one has not been completed in the past 12 months. This review is conducted during the physical inspection. This review must be conducted to ensure that the project complies with the Americans with Disability Act, Section 504(c), which covers accessibility requirements, and the Title VI of the Fair Housing Act of 1968.

The transferee must take action to mitigate any civil rights and disability concerns identified. Any project where civil rights and disability concerns have been identified will not be approved for transfer without review by the Civil Rights Coordinator.

The transfer file must include the civil rights and disability review by the Civil Rights Coordinator. Examples of civil rights deficiencies include, but are not limited to, the following:

- Failure to market units in accordance with *Form HUD 935-2*;
- Inconsistent treatment of applicants when screening for occupancy;
- Inconsistent treatment of tenants when assigning units;
- Borrower failure to have documented the self-assessment review of civil rights and disability practices;
- Improper waiting lists and tenant selection routines; and
- Handicapped accessibility concerns.

C. Environmental Review *[7 CFR 3560.406 (d)(4)]*

1. Environmental Review under the National Environmental Policy Act (NEPA)

Agency approval of a transfer will normally qualify as a categorical exclusion and will not require preparation of any environmental review document, provided the proposed transfer will not alter the purpose, operation, location, or design of the project as originally approved. If the transfer includes additional financial assistance, the appropriate level of environmental review will be completed in accordance with RD Instruction 1940-G and Chapter 3, Section 3 of HB-1-3560.

2. Due Diligence

When additional financial assistance is involved, due diligence will be performed for a transfer in accordance with the procedures identified in Chapter 3, Section 3 of HB-1-3560. Normally, due diligence will be completed in conjunction with the appraisal, if one is being done.

3. Form FEMA 81-93, Standard Flood Hazard Determination

Form FEMA 81-93 will be completed for all transfers.

4. Correction of Deficiencies and Documentation

Both the NEPA review and the due diligence report, as appropriate, will be made a part of the transfer file. Any outstanding concerns noted in either document must be

resolved prior to approval of the requested action. The State Environmental Coordinator should be consulted for further evaluation and guidance on any such problems.

7.19 FINANCIAL FEASIBILITY

A. Budget/Reasonable Rents *[7 CFR 3560.406 (d)(2)]*

The Loan Servicer must review the budget submitted by the transferee to determine whether the budget provides for reasonable rents that the persons eligible for the units in question can afford. The submission from the transferee should include information on market rents for comparable units in the area, if the transferee is proposing a rent increase. The proposed basic rents for the project upon completion of the transfer must satisfy the CRCU standard *[7 CFR 3560.406(d)(2)]* as discussed in Chapter 4 of HB-2-3560.

The Loan Servicer should be particularly diligent in analyzing the budget and proposed rents when the transferee will also receive a subsequent loan or other third-party financing, or there are significant repairs or rehabilitation plans. The Loan Servicer must consider both the short-term impact of whether the transferee can make loan payments immediately following the transfer and the long-term feasibility of the budget and rents to allow for a successful project. If there is any deficiency in the budget or rent structure, the transferee must take appropriate corrective action.

In addition, the Loan Servicer should review the budget to determine if the project life-cycle costs and reserve levels are adequate to allow for the necessary maintenance of the property over the remaining life of the project. If there are any deficiencies, the borrower must take appropriate corrective action.

B. Loan Structure

The Loan Servicer and the transferee should agree on the structure of the transferee's loan and take the necessary steps to ensure a smooth closing process.

1. New Term or Same Terms [7 CFR 3560.406 (j)]

Loan Servicers review the account to determine which type of transfer needs to occur. The Agency generally completes transfers on new terms. Even if the transferee is just "stepping into the shoes" of the borrower, in most cases the Agency will change the amortization period from 50 to 30 years, which will require the transfer to be completed on new terms. Before making a recommendation on the transfer, the Loan Servicer should determine if the transfer will be on new terms or the same terms and address any issues or obstacles that this may present.

2. Subsequent Loan [7 CFR 3560.406 (h)]

The Agency may provide a subsequent loan or approve one from a third-party source in conjunction with an ownership transfer or sale of a housing project. The subsequent loan may be in the form of a senior, junior, or parity lien, or a soft second. If the

transferee is requesting a subsequent loan, the Loan Servicer should refer to Chapter 10 of HB-1-3560 to ensure that the transferee's application is complete and being processed. The Loan Servicer should verify:

- The subsequent loan process will be completed to coincide with the transfer closing to ensure a smooth closing process, and

- The subsequent loan and its impact are accurately reflected in the transferee's budget and repair and rehabilitation plans.

3. Closing the Existing Loan

The Loan Servicer and the existing borrower must agree on the close-out of the existing loan before making a recommendation on the transfer. This is particularly important if the transfer will result in a loan shortfall or the borrower is requesting an equity payment.

Equity may be provided in cash or through a loan. If a full equity payment to the transferor is not paid at the time of the ownership transfer or sale or has not been paid through an Agency equity loan or third-party equity loan to the borrower that is approved by the Agency, the transferee must certify that equity payments due to the borrower will be paid from source other than project fund. These sources must be identified.

The Loan Servicer should ensure that the agreed-upon resolution of a shortfall maximizes the borrower's repayment ability and avoids or minimizes loss to the Government, unless it is in the Agency's best interest to accept an option that is less than the lowest-cost option. The Loan Servicer should ensure that the necessary actions to resolve any issues with the existing borrower are completed, or far enough along in the process, to allow for the completion of the transfer. The Loan Servicer should:

- Determine if the transfer will result in a shortfall on the existing loan. If a writedown is needed, see Chapter 11 for more information;

- Initiate the debt settlement process, in accordance with Chapter 12, if appropriate; and

- Determine if the Agency should pursue legal remedies against the borrower.

For equity payments, the Loan Servicer must determine if the borrower is entitled to equity payment *[7 CFR 3560.40 (e)* and *(f)]*. No compensation, equity, or syndication proceeds will be paid to the transferor by the transferee in connection with any transfer unless all of the following conditions are met:

- The account is current;

- The reserve account is on schedule, less any authorized withdrawals;

- The taxes and insurance account is funded and all outstanding bills paid;

- The security deposit account is fully funded;
- There are no outstanding serious maintenance items uncompleted, or an approved plan of action has been developed;
- Management is satisfactory, and there is an approved management plan and management agreement, if applicable;
- The project has been operated in compliance with equal opportunity and fair housing requirements;
- No project funds have been misappropriated; and
- The account will be classified as an "A" project in the MFIS system or if an acceptable workout agreement has been developed, classified as a "B" project.

7.20 ANALYSIS

In reviewing and evaluating the physical and financial plans for the property, the Loan Servicer must determine that the transferee's plans are feasible. This means the property must be able to meet and maintain the Agency's standards for decent, safe, and sanitary housing and continue to meet all of the program's budget, rent, and other financial requirements. If during the analysis of the property, the Loan Servicer determines the transferee's plans or proposals are not feasible, the transferee must either resolve the issue or agree to a resolution that is approved by the Agency before the transfer can be completed.

SECTION 6: MAKING THE DECISION

7.21 ASSESS THE OVERALL RISK AND THE IMPACT ON THE AGENCY AND TENANTS

The Loan Servicer compiles the evaluation of the eligibility, transferee, and the property and decides whether to recommend the transfer. Regardless of the level of detail the Loan Servicer went into in evaluating the transfer, the questions and process that the Loan Servicer must follow remain the same. Based on the transferee's application, and the Loan Servicer's knowledge of the existing borrower and property condition, the Loan Servicer should ask two questions:

- Is the potential for financial loss to the Agency better or no worse than with the existing borrower?

- Will housing conditions be better or no worse than under the current borrower?

The Loan Servicer must be able to answer these questions and explain the answers through the transfer application and case file documentation. The Loan Servicer must answer "yes" to both questions in order to recommend the transfer. If the Loan Servicer answers "no" to one or both questions, they must continue to work with the transferee to resolve any outstanding issues before recommending the transfer. The information the Loan Servicer receives as part of the application and documentation completed during the review process will account for most of the documentation required. However, the Loan Servicer should include a narrative statement in the case file explaining how the Loan Servicer reached the conclusion that the transfer meets the objectives of the Agency.

7.22 COMPLETE AND VERIFY APPLICABLE FORMS

Throughout the review process, the Loan Servicer must prepare relevant forms to facilitate the transfer and ensure that each form is prepared correctly. The forms listed below must be filled out to complete a transfer:

- To transfer multiple housing loans to borrowers assuming the obligations, Loan Servicers must prepare *Form RD 3560-21*. They should give a signed copy of this form to the transferee, keep another signed copy in the Field Office case file, and retain the original form in the Field Office.

- To transfer rental assistance, Loan Servicers need to prepare *Form RD 3560-55, MFH Transfer of RA*.

- To record borrower eligibility to receive interest credit or rental assistance, Loan Servicers need to prepare *Form RD 3560-9*.

When the transfer docket forms are completed, the Loan Servicer must determine that:

- The proposed transfer conforms to the applicable procedural requirements and that determinations of hardship status, eligibility, etc., are clearly documented in the case file;

- Each form is prepared correctly according to the Forms Manual Insert (FMI) or other appropriate regulations; and

- Items such as names, addresses, and the amount of the indebtedness to be assumed are the same on all forms in which those items appear.

7.23 TRANSMIT THE DOCUMENT TO STATE OFFICE AND OGC FOR REVIEW

When the Loan Servicer determines that all conditions have been met and is ready to recommend approval of the transfer, the Loan Servicer forwards the application docket and the official case file, with comments and recommendations to the State Office.

A. State Office Review

The State Office reviews the documents. If the State Director agrees that all applicable conditions are met, the State Director forwards the docket to OGC for review and for closing instructions. All materials related to the case may be forwarded to the National Office for review and approval authorization if necessary.

B. Decision to Approve the Transfer

If the transfer is approved, OGC will issue closing instructions. The State Office forwards any comments and conditions to the Field Office and gives them authority to issue *Handbook Letter 102 (3560), Letter of Conditions, Loan Approval, or Obligation of Funds* to the transferee. The transferee will return the executed Notice of Intent to Meet Conditions within 10 days of receipt. After receipt, the Field Office will schedule a meeting with the transferee to execute the obligating documents.

C. Issue Letter of Conditions/Closing Instructions

Upon a determination that the transfer is allowable and meets all applicable criteria, the Agency will submit to the transferee a letter of conditions and closing instructions from OGC that will put the transfer into effect.

7.24 AGENCY APPROVAL

If the Agency decides to grant approval to a transfer request, it will proceed directly to the processing steps described in Section 7 of this chapter.

7.25 AGENCY DISAPPROVAL/REJECTION

If the Agency denies a request for a transfer, the Agency must send a formal letter to the transferee indicating the reasons for the decision and informing the transferee of appeal rights. A copy of this letter must be placed in the case file.

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SECTION 7: PROCESSING AND CLOSING THE TRANSFER

Once the Agency has made the decision to approve a transfer and issue closing instructions, it must undertake a number of steps to implement the transfer. The steps the Agency takes to process and close a transfer on new terms and same terms are similar to each other.

7.26 CONDUCT APPRAISAL OF SECURITY PROPERTY *[7 CFR 3560.406 (d)(3)]*

An appraisal is often necessary to ensure that the Agency's security requirements will be met under the new loan. The appraisal must be conducted in accordance with Chapter 8 of HB-1-3560.

When the total value of the loans as part of a transfer is $100,000 or less, the Agency may determine the value of the security through either:

- An Agency review of monitoring reports; or
- An appraisal paid for by the borrower, conducted in accordance with Chapter 7 of HB-1-3560.

When the total value of the loans as part of a transfer is greater than $100,000, the Agency must determine the value of the security through an appraisal obtained by the Agency and conducted in accordance with Chapter 7 of HB-1-3560.

The value of the project covered by the Agency loans to be assumed by the transferee must be sufficient to ensure that all Agency loans being assumed and all subsequent loans offered as a part of the transfer can be secured to a level that fully protects the Agency. Soft second loans that are not dependent on project revenue for payment are not included in this determination.

7.27 DETERMINE THE APPROPRIATE INTEREST RATE

Transfers on new terms are subject to the interest rate conditions described below. If rents are increased due to the transfer, the transfer will be done under new rates and terms if the Agency determines that this is in the best interest of the Government.

A. General

The interest rate charged for all loans, except Labor Housing loans, will be the current rate being charged for those loans at the time of loan closing or the interest rate at the time of approval (i.e., the date *Form RD 3560-51 Obligation – Fund Analysis,* is approved), whichever is less.

B. Labor Housing Loans

The interest rate on Labor Housing loans will be the rate specified in the note, generally 1 percent, except those on farm loans at the exception rate when credit elsewhere is available.

7.28 PROCESSING REQUIREMENTS *[7 CFR 3560.406 (k)]*

The Agency has established specific requirements for processing project transfers to assure that the obligations and responsibilities of the transferor are formally passed to the transferee and that the Agency's security interests are protected. Specifically, these requirements ensure that:

- All accounts, property, and subsidy are properly assigned to the transferee;
- A proper loan agreement or loan resolution for the type of transferee is in effect and secured in the mortgage and deed of trust;
- The transferor is released from liability when all Agency security is transferred and the total outstanding debt is assumed; and
- Applicable restrictive-use provisions are attached to the transferred loans.

Loan Servicers should take the steps summarized in Exhibit 7-5 when processing transfers.

Exhibit 7-5

Basic Steps for Processing Transfers

1. Determine current loan balances for transfer;
2. Verify that the application docket is complete;
3. Review applicable requirements with the transferee;
4. Write the transfer agreement;
5. Obligate the subsequent loan, if applicable;
6. Approve the transfer;
7. Close the transfer;
8. Assign lease to transferee;
9. Shift accounts, funds, and assets to transferee;
10. Provide copies of documents to transferee;
11. Inform new borrower of administrative responsibilities;
12. Schedule a follow-up servicing visit; and
13. Address special circumstances as needed.

7.29 PROCEDURES FOR PROCESSING TRANSFERS

A. Determine Current Loan Balances for Transfer

1. Determine the Loan Balance

To determine the current loan balance for transfer, the Loan Servicer must execute *Form RD 3560-21* according to the FMI. The unpaid principal balance and accrued interest to be shown on *Form RD 3560-21* is determined by accessing the project account recorded via field terminal. The Loan Servicer will advise the transferee of:

- The total amount paid as of the closing date that has not been credited to the account;
- The payment required to place the account on schedule as of the previous installment due date;
- Any payment required to bring any monthly or annual payment current; and
- The amount needed to bring the reserve account current less any authorized withdrawals.

The Loan Servicer must base the amount of indebtedness to be assumed on current appraisal regulations. In the case of a transfer with assumption of less than the full debt, the Loan Servicer will attach the *Form RD 3560-52, Promissory Note* to the transfer agreement and place it in the transferee's file.

2. Adjustments to the Account

Same terms transfers, when the transferor has been converted to Predetermined Amortization Schedule System (PASS), must take place in a current loan status on the date of transfer. Thus, transferors must bring any delinquent principal and interest current prior to the transfer.

Overpayments and advance regular payments made on PASS accounts result in the creation of a "future paid" status account under Automated Multi-Family Housing Accounting System (AMAS). These advance payments must be reversed off and applied to the transferor's principal balance by the Loan Servicer prior to determining the loan balance to be transferred. If the future payments have been made through rental assistance, they must be refunded to the transferor and reapplied in the form of cash on the loan balance.

B. Verify that the Application Docket is Complete

1. Basic Components of the Docket

The Loan Servicer should use the Application Checklist and supporting documentation **(Attachment 7-A)**, to determine if all the items have been submitted by the transferee.

2. Other Supplemental Documentation

Other transfer docket items may include:

- Mortgagee title policy;
- Title evidence or report of lien search;
- Foreclosure notice agreement;
- Original or certified copy of deed to any property;
- Purchase contract or other instrument of ownership;
- Assignment of HUD Section 8 Housing Assistance Payments contract; and
- Information on prior or junior mortgage(s).

Completion of this step ensures that the entire history of the transfer, from initial request through final approval, is adequately and legally documented. Maintenance of this history allows the Agency to hold transferees accountable for compliance with all agreements signed during the transfer process.

C. Review Applicable Requirements with Transferee

After closing instructions have been issued but before the transfer is closed, the Loan Servicer carefully reviews with the transferee the applicable loan program regulations and loan agreement or resolution, if this was not fully completed during the preliminary request meeting in accordance with Paragraph 7.8.

D. Write the Transfer Agreement

The Loan Servicer will use *Form RD 3560-20* to record the agreements between the transferor and transferee. The agreement will show all agreements involved relating to equity, including:

- Disposition of syndication proceeds between the transferee and transferor;
- Method and source of payment;
- Payment of recoverable cost items;
- Disposition of future paid payments
- Assignment of project accounts and leases; and
- Disposition of any equipment purchased with loan or project funds.

The agreement should include any agreements to correct any compliance problems, such as delinquent payments, underfunded reserves, or deferred maintenance. If health and safety, civil rights, disability, or environmental deficiencies were identified in the inspection, the transferee must include an action plan for immediate corrective measures. These agreements should state which party would be responsible for taking corrective action, and indicate the source of funds. Additional information may be attached to *Form RD 3560-20* as needed to ensure that all agreements are documented.

E. Prepare to Close the Transfer and Obligate the Subsequent Loan, if Applicable

To prepare to close the transfer and obligate any subsequent loan that is part of the transfer, the Loan Servicer must prepare *Form RD 3560-51,* and *Forms RD 3560-33, Loan Agreement, 3560-34, Loan Agreement,* or *3560-35, Loan Resolution* if changes must be made to the existing loan agreement, or the transfer is a new terms transfer.

The Loan Servicer enters the required data on borrower and project characteristics into the appropriate AMAS screens, although they should not enter the data to establish the borrower/project until the project receives final approval. The numbers generated by AMAS are used to identify the transferee when completing the transfer closing documents.

In addition, the Loan Servicer must ensure that the proper type of loan agreement or loan resolution is in effect and secured in the mortgage or deed of trust at the time of transfer. The balance of debt assumed must be scheduled for repayment in two years or less for RHS accounts and usually ten years or less for other types of multiple family loan account. The State Director may approve longer terms.

F. Close the Transfer

The Agency will close the transfer according to the closing instructions received from OGC. After the transfer is approved, the Loan servicer enters the transfer into AMAS and calculates the transfer balance using the Servicing Balance Worksheet. The transferee has now become the new borrower.

Upon completion of the transfer, there must be no liens, judgments, or other claims against the security being transferred other than those by the Agency and those to which the Agency has previously agreed, unless prior written approval is obtained from the National Office.

The parties to the transfer are responsible for obtaining legal services necessary to accomplish the transfer. A profit or limited profit organization transferee may use any designated attorney or title insurance company to close the transfer according to the applicable closing instructions from OGC. The attorney or title insurance company and their principals or employees must not be members, officers, directors, trustees, stockholders or partners of the transferee or transferor entity. Nonprofit organization transferees may use a designated attorney who is a member of their organization if the cost is reasonable, typical for the area, and is earned.

G. Release from Liability

The Agency may release the borrower from liability from any debts owed to the Agency when the housing project, and all equipment, related facilities, and housing project financial accounts have been transferred or sold to the transferee and the transferor's outstanding Agency debts have been assumed or satisfied.

If all of a transferor's outstanding Agency debt is not assumed or paid off at the time of the transfer or sale, the Agency will not release a borrower from liability unless the Agency determines that the borrower is unable to pay the remaining debt from assets taken as security through the debt settlement procedures. Refer to Chapter 12 for debt settlement procedures.

H. Assign Leases to Transferee

All leases must be assigned to the transferee no later than the date of closing.

I. Shift Accounts, Funds, and Assets to Transferee

1. General

Following the assignment of leases, responsibility for the accounts, funds, and assets listed below is shifted from the transferor to the transferee:

- Project operating accounts;
- Reserve account;
- Tenant security deposits;
- Supervised bank accounts;
- Any funds remaining in rental assistance contract; and
- Equipment purchased with project funds.

During a project transfer, the transferor may retain the project's reserve if the transferee funds the reserve account in an amount sufficient to meet the project's immediate needs.

2. Rental Assistance Agreement

When a transferee assumes a rental assistance agreement, the Loan Servicer will complete *Form RD 3560-55* and attach it to *Form RD 3560-27, Rental Assistance Agreement*. In addition, they will attach a copy of *Form RD 3560-55* and forward it to the St. Louis Office. If the transferee does not assume an existing agreement, Loan Servicers will suspend the agreement by memorandum to the St. Louis Office.

3. Other Agreements

If a project operates under the HUD Section 8 program, the Housing Assistance Payment contract must also be assigned to the transferee with prior HUD approval.

When the full amount of the debt is being assumed and an amount has been advanced for insurance premiums or any other purpose, the transfer will not be completed until the Finance Office has charged the advance to the transferor's account.

J. Provide Copies of Documents to Transferee

At a time no later than the transfer closing, the Agency will provide to the transferee copies of the security instruments executed by the transferor or previous borrower to originally secure the loan.

K. Inform Borrower of Administrative Responsibilities

Following completion of a transfer, the transferee has several reporting and other administrative responsibilities that need to be satisfied. The Loan Servicer must inform the transferee of these requirements shortly after the transfer is closed.

1. Reporting

Following the transfer, transferees must submit quarterly project financial reports to the Agency to demonstrate the financial viability of the project.

2. Tenant Certifications

Transferees must ensure that current executed tenant certifications are on file with the Agency or provided for each tenant following the transfer.

3. Identification of All Creditors

At completion of the transfer, transferees must establish that there are no liens, judgments, or other claims against the security being transferred other than those by the Agency and those to which the Agency has previously agreed.

L. Schedule a Follow-up Servicing Visit

The Loan Servicer should schedule a servicing visit within 90 days of closing to verify the transferee's compliance with all applicable program requirements.

M. Address Special Circumstances as Needed

1. Deceased Borrower

When the spouse of a deceased individual borrower is not currently liable for the debt, the Loan Servicer can complete a transfer and assumption to the spouse using *Form RD 3560-21*, on the same rates and terms if the account is current, or on new terms if it is

not current. The Loan Servicer should obtain OGC advice and instructions before completing such a transfer.

2. Nonequity Compensation

In some cases, compensation may be paid to the transferor by the transferee when there is no equity in the project, in order to bring about the transfer. The State Director may ask the National Office to authorize nonequity compensation. Transferors will receive no payment for regular equity or equity in conjunction with a prepayment action unless all Agency loans against the project are assumed in full or the payment to the transferor is applied in total against non–Agency prior liens. This situation is most appropriate when it is in the Agency's best interest to get a project away from a "bad" borrower and nonequity compensation is less expensive than liquidating the property.

3. Payments Received while Transfer Pending

During the period that a transfer is pending in the Field Office, the St. Louis Office will continue to apply to the transferor's account any payments received. Such payments include any down payments made in connection with the transfer for reducing the amount of the debt to be assumed. Any payment on the account not included in the latest transaction record should be deducted from the total amount of principal and interest calculated from the latest information available before the assumption agreement is completed and signed.

- **Identification.** Payments received on the date of the transfer will be remitted as regular payments. The payments will be credited to the transferor's borrower and the project number when the payment should be credited prior to the transfer. The payments will be credited to the transferee's borrower and project number when the payment should be credited after the transfer.

- **Payment.** When a payment is due on the assumption agreement shortly after the transfer is completed, the payment should, if possible, be collected at the time of the transfer and remitted in the transferee's name.

4. Uncompleted Transfer

If for any reason a transfer will not be completed after approval, the Loan Servicer will immediately notify the State Office of the reason.

7.30 MONITORING REHABILITATION WORK

The Agency will monitor all repairs and approve payments using the procedures outlined in Chapter 9 of HB-1-3560. Completing this step allows the Agency to verify that the property will be restored to a decent, safe, and sanitary condition.

ATTACHMENT 7-A

APPLICATION CHECKLIST

Part 1. Critical items needed

Please submit each of the following immediately once they become available. The buyer/transferee must submit one (1) original to the local AGENCY servicing office *and* one (1) copy of all of the "critical" documents to the State Office.

☐ 1. Forms SF 424 Application for Federal Assistance, *SF 424C Budget Information – Construction Programs*, and *SF 424D Assurances – Construction Programs*.

These forms can be obtained on line at: http://www.gsa.gov/

☐ 2. "MFH Transfer & Assumption Application Supplement" including the "Preservation Transfer Development Budget (See Attachment B-3)

☐ 3. Copy of executed purchase agreement, including any and all amendments.

☐ 4. Physical Needs Assessment.

☐ 5. *Optional, but strongly encouraged*. A professional market study, documenting comparable market rents is encouraged when an appraisal is not required

☐ 6. Appraisal. Please note, a *third* copy of the appraisal should be sent to your State Appraiser.

☐ 7. Copy of associated applications filed with any other financing source (and, if the financing is committed, a copy of the commitment letter – e.g., a preliminary reservation letter).

☐ 8. Preliminary title report.

☐ 9. Project budget. This budget form should set forth the project's current AGENCY-approved budget in the "Current Budget" columns and the project's proposed budget after acquisition in the Proposed Budget columns.

a) ☐ *Form RD 3560-7*. This form is available upon request from AGENCY in an Excel format or it may be obtained in a pdf format on line at: http://rdinit.usda.gov/regs/forms/3560-07.pdf

b) ☐ Narrative justification of changes in budget. *It is important that any and all differences between the current and proposed budget be fully explained and justified.*

☐ 10. Rehabilitation plan. The rehab work should be developed in light of the Comprehensive Needs Assessment (above). The rehab work should be categorized as follows: (i) all necessary repairs to address any deferred maintenance and assure that the housing will be decent, safe, & sanitary; (ii) any needed property improvement to bring the property into conformance with Fair Housing, Americans with Disabilities Act, or Section 504 requirements; (iii) other rehabilitation proposed to enhance long-term

viability of the housing; and (iv) any other feasible upgrades that will increase its marketability. The plan must include tenant relocation costs if necessary to rehabilitate the project. The agency must concur with the plan as part of the approval of the transfer.

a) ☐ A detailed plan and timeline of all rehab work to be accomplished. The plan must identify each repair or enhancement item, the timeframe for completion, estimate of costs for each item, who will do the work, and any Identity of Interest between the transferee and the party doing the work or providing materials and services.

b) ☐ Form RD 1924-13. Complete the estimated cost columns. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/1924-13.pdf

☐ 11. Contact list. (See Attachment B-4.)

Part 2. Additional application materials needed as soon as possible

These "additional" documents should be submitted to the local AGENCY servicing office only. Copies do not need to be sent to the State Office.

From the seller:

☐ 12. Form RD 3560-1 – signed by the *seller*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/3560-01.pdf

From the buyer/transferee:

☐ 13. Brief narrative or resume of applicant's experience in multi-family housing.

☐ 14. Current financial statements of the applicant and of all general partners and owners with a >10% ownership interest. An example of an appropriate certification is Attachment B-5. The certification should be attached to each financial statement. (Note: If the applicant is an entity that has not yet been formed, financial statements should be a *pro forma* financial statement of the applicant along with financial statements of the proposed principals.)

☐ 15. *If the buyer is a nonprofit or has a nonprofit general partner:* Most recent IRS Form 990, "Return of Organization Exempt from Income Tax" (with Schedules A & B).

☐ 16. Organizational documents as appropriate for applicant entity type – e.g., partnership agreement, articles of incorporation, by-laws, certificate of good standing, resolution to apply for this loan – along with a letter from the applicant's attorney certifying their legal sufficiency. (Note: If the applicant is an entity that has not yet been formed, drafts documents may be submitted instead.) If the borrower is a nonprofit, also provide:

a) ☐ Tax-exempt ruling from the IRS conferring 501(c)(3) or 501(c)(4) status.

b) ☐ List of members on Board of Directors.

☐ 17. *Form HUD 9832, Management Entity Profile* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/cgi/pdfforms/9832.pdf

☐ 18. *Form HUD 2530/RD 1944-37* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/html/pdfforms/2530.pdf (fillable pdf format)

☐ 19. *Form RD 3560-30*, – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/3560-30.pdf

☐ 20. *If there is any Identity of Interest: Form RD 3560-31*, – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/3560-31.pdf

☐ 21. *Form RD 1910-11, Applicant Certification Federal Collection Policies for Consumer or Commercial Debts* – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/1910-11.pdf

☐ 22. *Form AD 1047, Certification Regarding Debarment, Suspension and other Responsibility Matters* – signed by the applicant. This form can be obtained online at http://www.ocio.usda.gov/forms/ocio_forms.html

☐ 23. *Form RD 400-1*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/0400-01.pdf (fillable pdf format)

☐ 24. *Form RD 400-4, Assurance Agreement*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/0400-01.pdf (fillable pdf format)

☐ 25. RD Instruction 1940-Q, Exhibit A-1. This form is attached as Attachment B-6.

Information on other funding sources:

☐ 26. If the project will be receiving funding from other sources besides the requested AGENCY loan, for each source, attach a copy of any draft regulatory/loan agreements associated with the financing.

Project management information:

☐ 27. *Form HUD 935.2* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/cgi/pdfforms/935-2.pdf (fillable pdf format)

☐ 28. Proposed Management Agreement

☐ 29. Proposed Management Plan

☐ 30. Proposed lease & occupancy rules to be used at the project (with letter from attorney indicating legal sufficiency).

Attachment B-2, *MFH Transfer & Assumption Review & Recommendation* is attached.

ATTACHMENT B-2
MFH TRANSFER & ASSUMPTION
REVIEW & RECOMMENDATION

USDA has received an application for a preservation transfer and assumption outlined below:

Name of Project:	_____
Street Address of Project (w/zip code):	_____
Name of Project's Current Owner:	_____
Name of Project's Proposed Transferee:	_____
Name of Project's Management Agent	_____

The following information is verified correct:

USDA loan information:

As of: _____

Promissory Note dated	Original Loan Amount	Current Balance	Current? (yes/no)
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Is project eligible to prepay? _____

Project's restrictive-use agreement expires/expired? _____

Project information:

[ ] Family [ ] Elderly [ ] Congregate

Rent information:

Bedroom size	# non-income units	# income units	Current Basic Rent	Post-Transfer Basic Rent	Estimated Market Rent in Area
0 bedroom	_____	_____	_____	_____	_____
1 bedroom	_____	_____	_____	_____	_____
2 bedroom	_____	_____	_____	_____	_____
3 bedroom	_____	_____	_____	_____	_____
4 bedroom	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
Total units	_____	_____			

If HUD subsidized, is project under Plan II? _____

Tenant Subsidy at project:

	Current	Post-Transfer
USDA Rental Assistance (RA)	_____	_____
HUD project-based Section 8	_____	_____
Other: _____	_____	_____
Other: _____	_____	_____
Total subsidized units:	_____	_____

Reserve account information

Current annual reserve transfer requirement: _____ (=_____ per unit)

As of: _____

Current reserve account balance	_____
Required reserve account balance	_____
Underfunded reserve	_____

Project condition & compliance information

MFIS classification: _____

Date of last supervisory visit: _____

Date of last walk-about physical inspection: _____

Date of last compliance review: _____

Note any accessibility issues unresolved at the project. Estimated cost to correct: _____

_____

Note any deferred maintenance issues unresolved at the project. Estimated cost to correct: _____

_____

[ ] The loan account is current.

[ ] The reserve account is on schedule, less authorized withdrawals.

[ ] The taxes and insurance account is on schedule and all outstanding bills paid.

[ ] The security deposit account is fully funded.

[ ] There are no outstanding maintenance items.

[ ] Management is satisfactory.

[ ] There are no open OIG audit findings or investigations against the borrower or related entities.

[ ] The borrower and members of the borrower entity are in compliance on all other projects or complying with an approved workout plan for a minimum of 6 months.

[ ] All necessary repairs to ensure that the housing will be decent, safe and sanitary, and other improvements proposed by the applicant to enhance long-term viability of the housing agreed to by USDA.

Last appraised value of project: _____ as of _____

1. The proposed transaction:
[ ] WILL [ ] WILL NOT prevent or make more difficult the successful operation of this property.

[ ] WILL [ ] WILL NOT reduce the efficiency of the property.

2. The proposed transaction will affect the value of this property as security of the loan as follows:
_____

3. The following [ ] damages [ ] benefits will result to this property from the transaction:
_____

Note any special transfer & assumption approval conditions recommended:

SOURCES AND USES OF FUNDS

Example Apartments transfer to Preservation Associates, LP

		PERMANENT SOURCES OF FUNDS:					
USE OF FUNDS		Tax Credits	USDA Assumption	Lender Name	Other	Other	Other
Total Acquisition Cost							
Total Rehab Costs							
Total Relocation Expenses							
Total New Construction Costs							
Total Architectural Costs							
Total Survey & Engineering							
Total Construction Interest & Fees							
Total Permanent Financing Costs							
Total Attorney Costs							
Total Reserve Costs							
Total Appraisal Costs							
Total Contingency							
Total Other Costs							
Total Developer Costs							
TOTAL PROJECT COST							

Balanced

Permanent Financing Detail (for all sources other than USDA & tax credits)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Lender name						
Other						
Other						
Other						

Interim Financing Detail (for all sources other than USDA)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Community Bank						
Other						

I hereby recommend that this application be approved.

Date _____ Recommended by:_____

_____
(Title)

Date _____ Approved by: _____

_____
(Title)

UNITED STATES DEPARTMENT OF AGRICULTURE

ATTACHMENT B-3 MFH TRANSFER & ASSUMPTION APPLICATION SUPPLEMENT

Name of Project: _____
Street Address of Project (w/zip code): _____
Name of Project's Current Owner: _____

The following information supplements Form SF-424. This information is submitted along with an application to assume the USDA debt associated with the above-mentioned security property. A complete application is or will be submitted promptly.

The undersigned in accordance with the terms of the security instruments held by USDA Rural Development (hereafter referred to as "USDA") on their property applies for release or subordination of the liens of said security instruments and consent to the following transaction:

1. Transfer of the USDA security property in full as outlined below.
2. Assumption of the full balance of all USDA loans associated with the security property on new rates and terms,
3. Subordination of the USDA security instruments as outlined below.
4. Other (*explain*). _____

1. Applicant/Buyer/Transferee information

The following information is supplied about the applicant (i.e., the legal entity to acquire title to the property, *not* the developer/sponsor):

Applicant Legal Name: _____

Provide exact legal name of the entity that will take title to the real property and be USDA's borrower at the conclusion of the transaction – e.g., "Happy Valley Associates, LP, a Maryland limited partnership".

Type of organization: _____

e.g. limited partnership, general partnership, nonprofit, corporation, LLC, tribe, public body, cooperative, individual

Tax ID #: _____
Date of formation: _____
Official Mailing Address: _____
Developer/Sponsor Name: _____

(If there is a developer sponsoring the applicant entity.)

Primary contact person for this transaction: _____
Capacity: _____
Organization: _____
Address: _____
Phone: _____ Fax: _____ E-mail: _____

Disclose any identity of interest relationship between borrower/seller and transferee/buyer (if none, indicate this):

_____

2. Member/Owner information (*complete one*):

a. If applicant is a limited partnership: *(Please provide exact legal names)*

Role	Exact Legal Name	Tax ID #	Non-profit?	% Share	Mailing Address	Authorized signer & title

b. If applicant is not a limited partnership: *(Please provide exact legal names)*

Role	Exact Legal Name	Tax ID #	Non-profit ?	% Share	Mailing Address	Authorized signer & title

3. Transaction information

USDA Rural Development's approval is requested for the following preservation transfer & assumption:

Negotiated purchase price: $_____ (*Please attach copy of purchase agreement.*)
Purchase agreement expires: _____ (*USDA typically needs 120 days to complete such transactions.*)

Proposed disposition of project & project assets:

RRH PROJECT ASSETS	**Transferred to buyer? (yes/no, explain)***
Real property	_____
Furnishing, fixtures & equipment	_____
Replacement reserve account	_____
Tax & insurance escrow account	_____
General operating account	_____
Security deposit account	_____
Other: _____	_____

** Note: If any project assets are not transferred in their entirety, the buyer will be responsible for funding their full replacement value from equity funds.*

Timetable

Estimated timetable for acquisition, with key deadlines for funding commitments:

_____

This transfer must close by no later than _____ because _____

4. Sources & Uses of Funds

*Funding Uses **	**Amount**
Total acquisitions costs	$_____
Total rehab costs	$_____
Total all other costs	$_____
TOTAL PROJECT FUNDING	$_____

*Permanent Funding Sources **	**Amount**	**Status? Date Committed or Pending**	**Anticipated rates & terms**	**Lien position proposed**
Assumption of USDA loan	$_____	Pending	1%, 50-year amortization, 30-year term	_____
Borrower contribution	_____	_____	_____	n/a
9% Low-Income Housing Tax Credits	_____	_____	_____	n/a
4% Low-Income Housing Tax Credits	_____	_____	_____	n/a
Loan from: _____	_____	_____	_____	_____
Loan from: _____	_____	_____	_____	_____
Other: _____	_____	_____	_____	_____
Other: _____	_____	_____	_____	_____
Other: _____	_____	_____	_____	_____
Other: _____	_____	_____	_____	_____
TOTAL PROJECT FUNDING	$_____			

** See attached "Preservation Transfer Development Budget (Sources & Uses of Funds)" for details.*

5. Effect of transfer on affordability, rents, and tenant subsidy

Applicant/transferee/buyer will enter into a new restrictive use agreement with USDA for:
[ ] 30 years [ ] 20 years [ ] remaining useful life of project [ ] Other: _____

Rent information:

Bedroom size	# units	Current Basic Rent	Post-Transfer Basic Rent	Estimated Market Rent in Area
0 bedroom	_____	_____	_____	_____
1 bedroom	_____	_____	_____	_____
2 bedroom	_____	_____	_____	_____
3 bedroom	_____	_____	_____	_____
4 bedroom	_____	_____	_____	_____
_____	_____	_____	_____	_____
Manager unit(s)	_____			
Total units:	_____			

Tenant Subsidy at project:

	Current	Post-Transfer
USDA Rental Assistance (RA)	_____	_____
HUD project-based Section 8	_____	_____
RHCP	_____	_____
Other: _____	_____	_____
Other: _____	_____	_____
Total subsidized units:	_____	_____

If project currently lacks 100% subsidy coverage on income-producing units, explain plan to maintain affordability, obtain additional subsidy and avoid adverse impact on tenants. _____

6. Planned method of management and operation

Management services to be provided by:

[ ] Contract manager (*identify*) _____ [ ] Borrower [ ] Other: _____

General discussion of management plan:

_____

7. Certifications

Have you or any member, stockholder, partner or joint operator of the entity borrower been convicted under Federal or State law of planting, cultivating, growing, producing, harvesting, or storing a controlled substance since December 23 ,1985? (yes/no) _____

If this application is approved, the undersigned applicant(s) agree to comply with such terms as may be prescribed by USDA and to disposition of the proceeds as required by USDA pursuant to its regulations, including the method of applying payment to the applicant(s)' loan accounts. It is expressly understood that unless a separate written instrument of subordination is executed and delivered by USDA pursuant to this application, approval by USDA of this application will merely constitute and evidence its consent, as lienholder, to the proposed transaction without in any way subordinating its lien, releasing any of its security, modifying the payment terms of the loan, or otherwise affecting any rights of USDA.

The applicant(s) agrees that none of the funds obtained as a result of any subordination covered by this application will be used for a purpose that will contribute to excessive erosion of highly erodible land or the conversion of wetlands to produce an agricultural commodities, as explained in Exhibit M of subpart G of part 1940 of title 7 of the Code of Federal Regulations.

CERTIFICATION

I hereby certify that the information given above concerning agreements between us and the transferor/seller is correct and fully understood by us.

I/we certify the information is a true and accurate reflection of proposed transfer & assumption project. This information is given for the purpose of inducing the United States of America to make a loan or to enable the United States of America to make a determination of continued eligibility of the applicant for a loan as requested in the loan application of which this statement is a part.

Neither the applicant nor its principals are delinquent on any Federal debt nor barred from participating in Federal housing programs.

_____ Signed:_____

Date Applicant/Transferee

MFH Transfer Development Budget (Sources & Uses of Funds)

Project: **Sample Apartments preservation transfer to Preservation Associates, LP**

		PERMANENT SOURCES OF FUNDS:					
USE OF FUNDS:	**TOTAL**	Tax Credits	USDA assumption	Ruraltown Bank	City	Other	Other
Total Acquisition Cost	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Rehab Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Relocation Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total New Construction Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Architectural Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Survey & Engineering	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Construction Interest & Fees	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Permanent Financing Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Attorney Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Reserve Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Appraisal Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Contingency	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Other Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Developer Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
TOTAL PROJECT COST	**$ -**	$ -	$ -	$ -	$ -	$ -	$ -

Balanced

Permanent Financing Detail (for all sources other than USDA & tax credits)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Ruraltown Bank	$ -	0.0000%	30	30	$ -	
City	$ -	0.0000%	30	30	$ -	residual receipts only
Other	$ -	0.0000%	30	30	$ -	
Other	$ -	0.0000%	30	30	$ -	

Interim Financing Detail (for all sources other than USDA)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.

ATTACHMENT B-4
MFH TRANSFER & ASSUMPTION CONTACTS LIST

Applicant's Representatives:

(Please indicate with "*" who is to be the applicant's primary contact person for this transaction.)

Applicant:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Developer:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Applicant's Consultant:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Applicant's Attorney:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Financing & Underwriting:

Interim Lender:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Permanent Lender:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Lender's Counsel:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Issuer:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Counsel:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Underwriter:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Tax Credit Investor:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Tax Credit Investor's Counsel:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Professional Services:

Comprehensive Needs Assessment analyst:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Appraiser:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Market Study analyst:

Name:	
Organization:	
Mailing Address:	

Phone: _____ Fax: _____ E-mail: _____

Escrow:

Title Company to handle the transfer:

Escrow #:	_____
Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Escrow #:	_____
Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Construction:

Architect:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

General Contractor:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Operation & Management:

Current Property Manager:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Proposed New Property Manager:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

ATTACHMENT B-5
MFH TRANSFER & ASSUMPTION FINANCIAL STATEMENT CERTIFICATION
Financial Statement Certification

(This certification is to be attached to all financial statements submitted to the Agency.)

Financial Statement of: _____

Date of Financial Statement: _____

I/we certify the attached is a true and accurate reflection of my/our financial condition as of the date stated herein. This statement is given for the purpose of inducing the United States of America to make a loan or to enable the United States of America to make a determination of continued eligibility of the applicant for a loan as requested in the loan application of which this statement is a part.

_____ _____
Signature Date

_____ _____
Name Title

ATTACHMENT B-6
MFH TRANSFER & ASSUMPTION CERTIFICATION FOR CONTRACTS

CERTIFICATION FOR CONTRACTS, GRANTS AND LOANS

The undersigned certifies, to the best of his or her knowledge and belief, that:

1. No Federal appropriated funds have been paid or will be paid, by or on behalf of the undersigned, to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with the awarding of any Federal contract, the making of any Federal grant or Federal loan, and the extension, continuation, renewal, amendment, or modification of any Federal contract, grant or loan.

2. If any funds other than Federal appropriated funds have been paid or will be paid to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with this Federal contract, grant or loan, the undersigned shall complete and submit Standard Form - LLL, "Disclosure of Lobbying Activities," in accordance with its instructions.

3. The undersigned shall require that the language of this certification be included in the award documents for all subawards at all tiers (including contracts, subcontracts, and subgrants under grants and loans) and that all subrecipients shall certify and disclose accordingly.

This certification is a material representation of fact upon which reliance was placed when this transaction was made or entered into. Submission of this certification is a prerequisite for making or entering into this transaction imposed by section 1352, title 31, U.S. Code. Any person who fails to file the required certification shall be subject to a civil penalty of not less than $10,000 and not more than $100,000 for each such failure.

_____	_____
(signed)	(date)
_____	
(name)	
_____	
(title)	
_____	
(name of certifying entity)	

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CHAPTER 8: SECURITY RESTUCTURING REQUESTS

8.1 INTRODUCTION

During the term of an Agency loan, borrowers may face unexpected expenses or other financial difficulties that require additional financing from other sources to adequately maintain and operate the project. In such cases, the Agency will consider restructuring the borrower's security, so long as doing so will not only help the property, but also be in the best interest of the tenants and the Government. Potential security restructuring activities that may be approved include subordinations and junior liens, disposition of security property, leasing of security property, and other liens against a property or other assets.

This chapter describes the requirements regarding such security restructuring requests and Agency procedures for reviewing and approving those requests.

SECTION 1: SUBORDINATIONS AND JUNIOR LIENS
[7 CFR 3560.409]

8.2 OVERVIEW

Borrowers may request a subordination or junior lien for any type of Agency loan. Prior Agency consent is required for all subordinations and junior liens.

Because the requirements and procedures for subordinations and junior liens are so similar, they have been combined in this section. Where necessary, specific differences between the requirements and procedures for the two are identified.

8.3 REQUIRED CONDITIONS

The State Director may grant consent to subordinations or junior liens if the borrower adequately documents that the request is consistent with the conditions listed in Exhibit 8-1.

If a junior lien is placed on any property without prior Agency consent, the State Director may pursue liquidation of the account.

Exhibit 8-1

Required Conditions for Subordinations or Junior Liens

- The action will enable the borrower to obtain credit to make needed improvements or repairs on the property in circumstances where a loan of the same type involved could be made and funds in the reserve account have been depleted. Repair costs should be reasonable and consistent with the local market;
- The action will improve the borrower's total financial condition or debt-paying ability;
- The borrower is unable to refinance the loan on terms that can reasonably be expected to be met yet still meet the intent of the program;
- The action will not result in an unauthorized rent increase for the project or result in basic rents that exceed the Conventional Rents for Comparable Units (CRCU) standard as discussed in Chapter 4 of HB-2-3560;
- The lienholder agrees in writing that foreclosure action under its lien will not be initiated before holding a discussion with the Loan Servicer, and after giving a reasonable period of notice to the Agency, and certifies that its operating plans are consistent with Agency requirements;
- Security for the subordination or junior lien appears adequate;
- The transaction must further loan objectives and not adversely affect the Agency's security;
- The total debt against the security after the transaction does not exceed the appraised value of the property and is within the State Director's approval authority;
- There is no future advance clause that would allow the lender to advance additional money and maintain the security or mortgage position; and
- All other applicable regulatory requirements have been met.

8.4 EVALUATING BORROWER REQUESTS FOR SUBORDINATIONS AND JUNIOR LIENS

The State Director will approve subordinations and junior liens only if they generally improve a borrower's financial condition and allow for completion of improvements or repairs in cases of underfunded reserve accounts. Loan Servicers need to ensure that the request does not alter project operations to make it ineligible under Agency requirements. In addition, the subordination must not adversely affect the Agency's ability to service the loan according to program regulations, and must be determined to be within the bounds of good judgment considering the intent, funding limitations, and respective program authorities. When evaluating borrower requests for subordinations or junior liens, Loan Servicers will review the request and check that the requirements listed in Exhibit 8-2 have been met.

In most cases, the Agency will not require an appraisal of the property when a subordination or junior lien is proposed. For subordinations, the Agency needs to look more closely at the amount of non–Agency debt being assumed and to determine whether its secondary lien position is sufficient security for the remaining outstanding debt. In some cases, this determination may require an appraisal. For junior liens, appraisals are almost never required, provided project budgets demonstrate that the project has a sufficient income to support

the increased debt. Appraisals are unnecessary in such cases because the Agency retains its lien position. In either case, the Agency needs to determine whether projects are still in compliance with the conventional rents for comparable units standard following the subordination or junior lien. The State Director decides when appraisals will be required.

All requests for consent to subordinations or junior liens that do not satisfy the criteria of Exhibit 8-2 must be submitted to the National Office with complete comments and recommendations from both the Loan Servicer and State Director, and all of the borrower's case files. The National Office will review such requests on a case-by-case basis, and appropriate authorization will be granted or withheld depending on the individual merits of the proposal and its compatibility with program requirements.

Loan Servicers should follow the procedures in Paragraph 8.5 when evaluating these requests.

Exhibit 8-2

Required Documentation for Subordinations or Junior Liens

Loan Servicers may approve borrower requests only if they adequately document that the following requirements have been satisfied:

- The account must be current;
- The debt must be adequately secured;
- The borrower must provide adequate management;
- The terms and conditions of the prior lien or junior lien must be such that the borrower can reasonably be expected to meet them as well as all other debts;
- The proposed use of funds must not adversely affect the borrower's ability to meet the objectives of the program. Indeed, it must improve the borrower's ability to repay the loan or be necessary to place the borrower's operation on a sound basis;
- Any proposed development must be planned and performed according to RD Instruction 1924-A, or in a manner directed by the other lienholder that meets the objectives of RD Instruction 1924-A;
- Funds to be used for development or enlargement of farm operations must be handled as prescribed for loan funds in RD Instruction 1902-A, except that if the lienholder will not permit the use of a supervised bank account, arrangements must be made to ensure that funds will be spent for planned purposes and must be approved by the Agency before being released;
- *Form FEMA 81-93* must be completed;
- Subordinations or junior liens need not cover the entire site;
- Subordinations or junior liens must be for a specific amount;
- Subordinations or junior liens must not adversely affect the Agency's ability to service the loan according to the requirements of this part; and
- New prior or junior lienholders must agree to provide notice of foreclosure to the Agency, as required in RD Instruction 1927-B. Any junior lienholder's consent to the foreclosure and use of proceeds will be obtained prior to approval of the foreclosure.

8.5 PROCEDURES FOR AUTHORIZATION OF SUBORDINATIONS AND JUNIOR LIENS

A. Borrower Requests

Loan Servicers should instruct the borrower that each request for subordinations or junior liens must be submitted on *Form RD 3560-1,* and provide a copy of the form to the Agency.

B. Processing Borrower Requests

Upon receipt of the completed form, Loan Servicers will make a preliminary feasibility determination regarding the request. Key areas that the Agency will analyze as part of this determination include:

- Rates and terms;
- Post-restructuring project budget;
- Current compliance status of the property; and
- Capacity (for nonprofit borrowers).

If Loan Servicers discover violations at the property, the request must not be approved without an Agency-approved work-out agreement.

C. Recommendations to State Director

If there are no violations at the property and all other applicable criteria are met, Loan Servicers forward a properly completed and executed copy of *Form RD 3560-1* to the State Director. Accompanying *Form RD 3560-1* should be a memo containing all information needed to justify approval or disapproval of the request, including an agreement from any new prior lienholder to provide the Agency advance notice of foreclosure. As appropriate, Loan Servicers will also obtain junior lienholder consent to any transaction and use of proceeds prior to approval of the transaction. When all required documentation has been assembled, the Loan Servicer will forward the subordination and junior lien request to the State Director for review.

D. Final Decision

If the State Director or designee agrees with the Field Office determination, they will forward the subordination or junior lien request to the Office of General Counsel (OGC) for review of legal sufficiency and closing comments. After OGC review, the closing process will begin. The State Director or designee should obtain OGC guidance in the preparation of documents necessary to effect the subordination.

All subordination and junior lien requests exceeding the State Director's approval authority limit must be submitted to the National Office for prior approval authorization.

E. Appraisal Procedures

The State Director may request an appraisal at any time deemed appropriate. As stated in Paragraph 8.4, most subordinations and junior liens will not require an appraisal. If an appraisal is deemed necessary, an Agency official authorized to make appraisals for the type of project involved will prepare an appraisal report. Alternatively, the new creditor may perform the appraisal as part of the due diligence process. If an appraisal that is less than one year old is available, it may be used in lieu of a new appraisal.

8.6 POST-APPROVAL OF JUNIOR LIENS

Sometimes a borrower will obtain additional credit (e.g., a personal loan) using the project as security for that credit, despite the Agency's requirements that prohibit such actions. In effect, that loan functions as a junior lien on the property. When a junior lien is placed on any

property without the prior consent of the Agency, the Loan Servicer will normally service the account for liquidation with the guidance of OGC.

SECTION 2: PARTIAL DISPOSITION OF SECURITY PROPERTY
[7 CFR 3560.407]

8.7 OVERVIEW

Borrowers may also request Agency approval of the sale of a portion of an interest in the security property under certain circumstances. The borrower may use the proceeds from such sale in accordance with Exhibit 8-3. Alternatively, a borrower could grant a conveyance or right of way easement, among other actions. This section addresses each of these options, and the Agency's procedures for reviewing and approving requests.

Exhibit 8-3

Allowable Uses for Proceeds from Disposition of Security Property

- To pay customary incidental closing costs such as title and recording fees appropriate to the transaction, including additional real estate tax the borrower is required to pay for the year for which alternate arrangements to pay cannot be made;
- To pay debts owed to any prior lienholders;
- To make extra payments on the loan;
- To pay costs necessary to determine the reasonableness of an offer or asking price, such as fees for appraisal of minerals, land, or timber where the necessary appraisal cannot be obtained without costs;
- To pay a real estate broker's commission if the borrower can reasonably expect to obtain proceeds at least equal to the commission in excess of what could otherwise be obtained without the broker's assistance;
- To repair, develop, or enlarge the borrower's facility for purposes for which a loan of the same type involved could be made, if the development or enlargement is necessary to improve the borrower's debt-paying ability, place the operation on a more sound basis, or otherwise further loan objectives;
- To purchase or acquire property to be used for purposes for which a loan of the same type involved is authorized, if the debt will be as well secured after the transaction as before (The Agency will obtain a lien on the acquired property, and obtain title evidence); and
- To increase reserves based on an Agency-approved capital plan.

8.8 ALLOWABLE ACTIONS INVOLVING THE PARTIAL DISPOSITION OF SECURITY PROPERTY

The State Director may grant consent to requests for the following actions involving the partial disposition of security property for a project:

- Use of proceeds from the sale of a portion of or an interest in the security;
- Exchange of all or a part of the undeveloped security for other real estate; or

- Granting or conveyance or rights-of-way subject to applicable conditions and requirements.

8.9 ALLOWABLE USES FOR PROCEEDS FROM PARTIAL DISPOSITION OF SECURITY PROPERTY

The Agency may consent to the partial disposition of security property if borrowers plan to use the proceeds for one or more of the uses listed in Exhibit 8-3.

It should be noted that while borrowers may use proceeds from disposition of security property for any of the purposes listed in Exhibit 8-3, there is a priority order for using such proceeds. The order in which the allowable uses are listed in Exhibit 8-3 roughly corresponds to the Agency's preferred priority order (although not all uses will apply to all projects).

If property to be sold or exchanged is to be used for the same or similar purposes for which the loan or grant was made, the purchaser is required to execute *Form RD 400-4*. The agreement will remain in effect for as long as the property continues to be used for the same or similar purpose for which the loan or grant was made.

8.10 REQUIRED CONDITIONS FOR AGENCY CONSENT

The State Director may grant consent to partial sales of security property, including the sale of individual units or developed portions of a multi-family housing project, so long as the conditions listed in Exhibit 8-4 are met.

8.11 PROCESSING BORROWER REQUESTS

The Agency grants consent to disposition of part of, or an interest in, security property by approving a completed *Form RD 3560-1,* or other forms approved by OGC or prescribed in State Supplements.

Exhibit 8-4

Required Conditions for Agency Consent to Partial Disposition of Security Property

- The transaction will not impair orderly payment of the Agency debt;
- The transaction will not interfere with the successful operation of the project or prevent the borrower from carrying out the purpose for which the loan was made;
- The borrower certifies compliance with fair housing laws;
- The appropriate level of environmental review under the National Environmental Policy Act (NEPA) is completed and mitigation measures to protect any important resources are established;
- The consideration is at least equal to the market value of the security property disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed without consideration being offered or with only the minimal consideration being offered if the value of the security property will not be reduced, its suitability for the intended purpose will not be impaired, and the easement is granted for the borrower to develop additional lots or units that will be integrated into the project or with a public body for enhancement of streets or utilities benefiting the project;
  - To establish market value, an authorized Agency official will either make a new appraisal if the current appraisal is more than one year old, or supplement the present appraisal report by inserting information as to the market value of the security disposed; or
  - An authorized agency official may also accept a value determination for such easements that have been provided by other competent sources at no cost to the Government that is mutually acceptable to the borrower and the Agency.
- The remaining property is adequate security for the unpaid balance of the loan; and
- The proceeds from the disposition of the security are to be used for one or more approved purposes (e.g., to pay closing costs, make extra payments, pay brokers' commission).

A. Borrower Submission

When a borrower requests consent to lease a portion of the security property or the Loan Servicer discovers that the borrower is leasing the security without consent, the Loan Servicer will require the borrower to complete *Form RD 3560-1*. The form will show the terms of the proposed lease and will specify the use of proceeds, including any proceeds to be released to the borrower.

B. Agency Review

The Loan Servicer will forward to the State Director:

- A properly completed and executed *Form RD 3560-1;*
- The proposed deed, easement, or other form of title conveyance;

- A memorandum from the Loan Servicer justifying the approval or disapproval of the proposed transaction; and

- Any other information pertinent to the transaction.

The State Director will review the materials, obtain the guidance of OGC (if needed), prior to indicating approval or disapproval on *Form RD 3560-1*, and provide additional servicing instructions to the Loan Servicer.

C. Agency Decision and Notice to Borrower

Before the Agency consents to any transaction that affects its security or lien position, Loan Servicers must obtain the written consent of any other lienholders. Such consent should include an agreement on the disposition of any funds resulting from the transaction and must be consistent with loan program requirements.

Loan Servicers should advise the borrower if the mortgage or deed of trust requires Agency consent to the sale or other transfer of real estate security. In such cases, the Loan Servicer should explain the applicable requirements to the borrower.

8.12 AGENCY RELEASE OF SECURITY

The Agency will release security for Agency loans in accordance with applicable program regulations and as follows:

- The Agency will not release its lien until it receives from the borrower the appropriate sales proceeds for application on the Government's claim. Loan Servicers will hold borrowers strictly accountable to the Agency for all proceeds derived from the sale of mortgaged property that the Agency is entitled to receive under its lien.

- The State Director or his or her designee may release real estate security by using *Form RD 3560-1* or other form approved by OGC. Satisfaction or termination of real estate security instruments when the Agency debt has been paid in full or satisfied by debt settlement action will be accomplished with *Form RD 3560-58, Satisfaction.*

- Any consent that results in an Agency loan account being paid in full is subject to all applicable prepayment provisions.

SECTION 3: LEASING OF SECURITY PROPERTY *[7 CFR 3560.408]*

8.13 OVERVIEW

Borrowers must obtain Agency approval to lease security property serving as security for Agency loans and grants. The Agency may approve leases to tenants for specific program purposes or otherwise at its discretion.

8.14 LEASES TO PUBLIC HOUSING AUTHORITIES

Loan Servicers may only authorize multi-family housing borrowers to renew and continue leasing all or part of their housing facilities to a housing authority, although borrowers may not enter into any new leases. Such leases must be on a form provided by the housing authority, and Loan Servicers must determine that the lease terms will enable the borrower to continue the objectives of the loan and make payments on schedule.

8.15 LEASE OF A PORTION OF THE SECURITY PROPERTY

Loan Servicers may approve the leasing of related facilities such as kitchens, recreation facilities, and community buildings when the borrower will continue to operate the facilities for the purposes for which the loan or grant was made. Loan Servicers should not approve such leases, however, unless they can verify that all of the following conditions are met:

- The lease is in the best interest of the borrower, the tenants, and the Government;
- The amount of the consideration is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest;
- The lease provides at its termination for the restoration of the leased space to its original condition or to a condition acceptable to the owner and the Government;
- Consent to the lease does not exceed three years at a time, unless a longer lease is clearly more advantageous to the borrower, the tenants, and the Government;
- The borrower has obtained written consent from any other lienholders whose mortgages require consent to any lease; and
- The borrower will obtain leases on the most advantageous terms to the project. The borrower will secure and credit to the project all discounts, rebates, or commissions obtainable with respect to project leases.

8.16 MINERAL LEASES

The Agency handles mineral leases according to the requirements set forth in 7 CFR 3560.408(d).

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SECTION 4: OTHER LIENS AGAINST A PROPERTY OR OTHER ASSETS *[7 CFR 3560.409 (d)]*

8.17 OVERVIEW

If none of the options presented in Sections 1, 2, or 3 of this chapter are applicable to a particular borrower or property, the Agency may consent to other liens against the property or other assets. The State Director may approve other liens against a property or other assets or instruments of similar effect under which a borrower may acquire—through other credit—items that will not become part of real estate security.

If additional liens are taken against other real property, the Loan Servicer must ensure that appropriate NEPA environmental review and due diligence requirements are satisfied.

8.18 REQUIRED CONDITIONS

The Agency's rule states that borrowers must not enter into any agreements placing a lien on the property or the equipment on it (e.g., items such as laundry equipment, air conditioning units, and basic household furnishings that will not become part of real estate security) without prior Agency approval and unless the following three conditions are met:

- The transaction will not affect the Agency's security position;
- The items covered by the transaction are needed for the successful operation of the property; and
- The financing arrangements are otherwise sound.

The rule also specifies that borrowers must complete and file with the Agency a financing statement and a security agreement.

8.19 AGENCY PROCEDURES

Requests for approval of other such liens will be made by the borrower on *Form RD 3560-1*. The Loan Servicer will forward to the State Director a properly completed and executed *Form RD 3560-1*, the proposed arrangement, the case file, and specific recommendations regarding the request.

The State Director will indicate approval or disapproval on *Form RD 3560-1*. The State Director will request that OGC prepare or approve the arrangement and issue special instructions when necessary.

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CHAPTER 9: UNAUTHORIZED ASSISTANCE

9.1 INTRODUCTION

During the term of an Agency loan, there may be cases when the borrower or tenants receive assistance to which they are not entitled. Such unauthorized assistance may be due to intentional fraud, inadvertent submittal of inaccurate information by borrowers or tenants, Agency error in calculation or assignment of benefits, or other causes. In cases where unauthorized assistance is identified, the Agency seeks to collect the entire amount of assistance determined to be unauthorized.

This chapter covers Agency procedures for identifying and collecting unauthorized assistance received by tenants, members, or borrowers.

SECTION 1: TYPES OF UNAUTHORIZED ASSISTANCE

9.2 OVERVIEW

The Agency has established procedures for servicing its multi-family housing loans and grants when it determines that the borrower, grantee, or tenants were not eligible for all or part of the financial assistance received, or the project was not made subject to restrictive-use provisions required by law and/or regulation. Unauthorized assistance includes the following categories:

- The recipient was not eligible for the assistance;
- The property, as approved, does not qualify for the program (e.g., a property clearly above modest in size, design, or cost, or that was not located in an area designated as rural when the initial loan was made);
- The loan or grant was made for unauthorized purposes (e.g., purchase of an excessive amount of land);
- The recipient was granted unauthorized subsidy in the form of interest credits, rental assistance, or a subsidy benefit received through use of an incorrect interest rate; and
- The recipient was not subjected to obligations required by the assistance, such as restrictive-use provisions, at the time the assistance was provided.

9.3 ADDRESSING UNAUTHORIZED ASSISTANCE

Provisions in 7 CFR part 3560, subpart O establish the Agency's authority to seek recapture of the full amount of unauthorized assistance regardless of whether receipt of the assistance is due to errors by the Agency, the borrower, or the tenant. In determining whether to recapture unauthorized assistance, the Agency will consider the cost-effectiveness of such action given the amount of unauthorized assistance, the availability of records to support the Agency's determination, and any applicable statute of limitations.

However, there are certain circumstances where repayment of the unauthorized assistance will not be the agreed-to corrective action. The Agency may forgo collection of unauthorized assistance if the following conditions are met:

- A demand for recovery of the unauthorized assistance was made;
- The unauthorized assistance did not result from inaccurate or false information knowingly or fraudulently provided by a borrower or tenant;
- The Agency determines that the borrower or tenant is unable to comply with the unauthorized assistance repayment demand, but is otherwise willing and able to meet Agency requirements; and
- The Agency determines that it is in the best interest of the Federal Government to forgo collection of the unauthorized assistance.

At the other extreme, the Agency can also choose to initiate liquidation or enforcement proceedings against a recipient of unauthorized assistance on a case-by-case basis.

SECTION 2: IDENTIFYING UNAUTHORIZED ASSISTANCE
[7 CFR 3560.703]

9.4 OVERVIEW

Unauthorized assistance may be identified through audits conducted by the Office of the Inspector General (OIG), through reviews conducted by Loan Servicers, or through other means such as information provided by a private citizen that documents the receipt of unauthorized assistance by a recipient of Agency assistance. In addition, a borrower or management agent also may identify unauthorized assistance resulting from tenant error or fraud.

If the Agency has reason to believe that unauthorized assistance was received but is unable to determine whether or not the assistance was in fact unauthorized, the case will be referred to Office of General Counsel (OGC) or the National Office, as appropriate, for review and advice. OIG investigation should be requested in every case where the Agency knows or believes that the assistance was based on false information. If OIG conducts an investigation, the Agency's notification and collection procedures will be deferred until the investigation is completed.

9.5 REQUIREMENTS FOR IDENTIFYING UNAUTHORIZED ASSISTANCE

Identification of unauthorized assistance may be accomplished by the Agency or by borrowers in cases involving tenant fraud. The Agency may use all available means to identify unauthorized assistance, including audit reports, monitoring activities, and information provided by reliable sources. Borrowers have the primary responsibility for identifying and pursuing cases of unauthorized assistance received by tenants.

The Agency will take necessary actions to identify unauthorized assistance, provide notice of the unauthorized assistance to the borrower, and recapture that assistance. At its discretion, the Agency may choose to continue with the borrower following the receipt of unauthorized assistance if certain criteria are met. Section 7 of this chapter presents the requirements and procedures for continuation of accounts following the receipt of unauthorized assistance.

9.6 METHODS OF IDENTIFYING UNAUTHORIZED ASSISTANCE

The Agency uses a number of methods to identify unauthorized assistance, including:

- Audits conducted by OIG;
- Reviews by Agency personnel; or
- Other means (e.g., information provided by a private citizen that documents the unauthorized assistance).

In addition, the Agency has the authority to pay a contractor (from authorized contracting funds) to conduct an audit to identify unauthorized assistance. In such cases, the State Office

and Contracting Staff would work together to identify audit needs and a contractor to perform the audit.

OIG audits can be random or targeted at projects or borrowers suspected of receiving unauthorized assistance. These audits may be either requested by Loan Servicers or conducted at OIG's initiative. In every case where the Agency knows or believes that the unauthorized assistance was based on false information, OIG investigation will be requested by the Servicing Office as provided for in RD Instruction 2012-B.

9.7 DOCUMENTATION OF UNAUTHORIZED ASSISTANCE

Loan Servicers must document the reasons for unauthorized assistance in the case file, specifically stating whether the cause was error or submission of false or inaccurate information. The case file will specifically state whether the unauthorized assistance was a result of:

- Submission of inaccurate information by the recipient;
- Submission of false information by the recipient;
- Submission of inaccurate or false information by another party on the recipient's behalf, such as a loan packager, developer, or real estate broker, or professional consultants (e.g., engineers, architects, management agents, and attorneys), when the recipient did not know the other party had submitted inaccurate or false information;
- Error by Agency personnel, either in making computations or failure to follow published regulations or guidance; or
- Error in preparing a debt instrument that caused a loan to be closed at an interest rate lower than the correct rate in effect when the loan was approved or which was caused by omission from the instrument of language required by applicable regulation (e.g., restrictive-use provisions).

9.8 NOTICE TO RECIPIENT

A. Agency Notice to Borrower

The Agency will provide notice to borrowers upon determining that unauthorized assistance was received. The notice will:

- Specify in detail the reason(s) that the assistance was determined to be unauthorized;
- State the amount of unauthorized assistance to be repaid;
- Establish a meeting for the borrower to discuss the basis for the claim and give the borrower an opportunity to provide facts, figures, written records, or other information that might alter the determination that the assistance was unauthorized; and

- Outline borrower's appeal rights.

Upon request, the Agency may grant additional time for the borrower to assemble the necessary documentation.

B. Borrower Notice to Tenant

The borrower will provide notice to tenants upon determining that a household received unauthorized assistance. The notice will:

- Specify in detail the reason(s) that the assistance was determined to be unauthorized;
- State the amount of unauthorized assistance to be repaid; and
- Establish a meeting for the tenant to discuss the basis for the claim and give the tenant an opportunity to provide facts, figures, written records, or other information that might alter the determination that the assistance was unauthorized.

Upon request, the borrower may grant additional time for the tenant to assemble the necessary documentation.

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SECTION 3: CORRECTING UNAUTHORIZED ASSISTANCE

9.9 OVERVIEW

After confirming and documenting receipt of unauthorized assistance, the next step is to end the flow of unauthorized assistance to the borrower or tenant receiving it. This section outlines the procedures employed to correct unauthorized assistance, including procedures for both audit and nonaudit cases.

9.10 ACCOUNT ADJUSTMENTS – AUDIT CASES

When a final determination has been made through an OIG audit that unauthorized assistance has been granted, the Field Office will be notified of necessary account adjustments by OIG and the State Office.

Types of Unauthorized Assistance

- Unauthorized loan
- Unauthorized subsidy benefits received through use of incorrect interest rate
- Unauthorized interest credit or rental assistance
- Unauthorized grant assistance

Only cases of unauthorized assistance identified by OIG audits are reported to the Field Office. In such cases, the Automated Multi-Family Housing Accounting System (AMAS) will be updated with the correct information, if the unauthorized assistance affects establishment of the loan interest rate or closing information.

The chosen method of corrective action depends on the type of unauthorized assistance. The following text describes the actions that Loan Servicers must take to correct each type of unauthorized assistance.

A. Unauthorized Loan

For an active borrower with an unauthorized loan, if the problem causing the assistance to be unauthorized can be corrected, appropriate corrective action will be required. For example:

- Where a loan was in excess of the authorized amount, the Agency will require the recipient to refund the difference;
- Where the loan included funds for purchase of excess land, the Agency will require the recipient to sell the excess land and apply the proceeds to the account as an extra payment; and
- Where a restrictive-use provision was omitted from a loan document, the Agency will insert the provision.

B. Unauthorized Subsidy Benefits Received Through Use of Incorrect Interest Rate

When the recipient was eligible for the loan but should have been charged a higher interest rate than that shown in the debt instrument, resulting in the receipt of

unauthorized subsidy benefits, the Agency must correct the interest rate to that which was in effect when the loan was approved.

- Loan Servicers must ensure that all payments made are reversed and reapplied at the correct interest rate and future installments will be scheduled at the correct interest rate;

- The Agency will service any delinquency thus created in accordance with applicable Agency procedures;

- After reapplication of payments, the Agency will service the loan as an authorized loan; and

- Continuation of existing terms is authorized when the recipient is a public body with loans secured by bonds on which the interest rate cannot legally be changed or payments reversed or reapplied.

C. Unauthorized Interest Credit or Rental Assistance

In cases involving rental assistance or interest credit, the subsidy benefits should be terminated as provided in *Form RD 3560-9*. The Agency will service unauthorized rental assistance as a delinquent account, see Chapter 10.

D. Unauthorized Grant Assistance

When the recipient will repay unauthorized grant assistance over a period of time, the Agency will charge interest at the rate specified in the grant agreement for default from the date received until paid.

- The Agency will schedule repayment over a period consistent with the recipient's repayment ability but not to exceed 10 years;

- The Loan Servicer must maintain collection records, as the St. Louis Office cannot set up an account for repayment of a grant. The Loan Servicer will attempt to collect the monies due, and all collections data will be entered into AMAS as a "Miscellaneous Collection;"

- The Loan Servicer will report quarterly to the State Office on cases identified in OIG audits;

- If the Agency determines that the recipient cannot repay unauthorized grant assistance, the Agency may leave the assistance outstanding under the terms of the grant agreement; and

- In the case of committed funds not yet disbursed, the Agency will make no further disbursements without prior consent of the Administrator.

E. Cases Where Recipient Has Both Authorized and Unauthorized Loans Outstanding

When a recipient has both authorized and unauthorized loans outstanding, the Agency will schedule installments to be paid concurrently on all loans. The Agency will service each loan according to the loan servicing regulations in effect for an authorized loan of its type.

F. Liquidation Pending

When the Agency initiates liquidation, Loan Servicers enter data into AMAS and the account will be flagged accordingly. The account is overseen by the Loan Servicer.

G. Liquidation Not Initiated

Cases in which liquidation have not been initiated because the outstanding amount is less than $1,000 or it would not be in the Agency's best interest to do so will be adjusted, and the adjustments will be entered into AMAS. In this instance only, State Office staff may make adjustments without the recipient's signature.

As requested, the State Office will report to OIG on the status of cases of unauthorized assistance identified in OIG audit reports and tracked by Loan Servicers. The amounts to be reported will be determined by the Field Office after servicing actions have been completed.

9.11 ACCOUNT ADJUSTMENTS – NONAUDIT CASES

Servicing procedures are essentially the same for audit and nonaudit cases. However, when the Agency identifies receipt of unauthorized assistance by a means other than an OIG audit report, the St. Louis Office will be notified only if adjustments to an active account or reinstatement of an inactive account are needed or grant funds are repaid.

Once the appropriate adjustments are made, the Agency will treat the loan(s) as an authorized loan(s). Any payment reversed will be reapplied as of the original date of credit.

The Agency will handle nonaudit account adjustments as follows:

- When a change in interest rate retroactive to the date of loan closing is necessary, the borrower will initial changes to *Form RD 3560-52, Promissory Note*. Loan Servicers will update AMAS with the correct information. AMAS will automatically will reverse and reapply payments accordingly.

- When an inactive borrower agrees to repay unauthorized assistance, the Loan Servicer will notify the St. Louis Office by memo, attaching a copy of *Form RD 3560-52*. The St. Louis Office will establish or reinstate the account according to the terms of *Form RD 3560-52*.

- If a loan is paid in full, the Agency will handle the remittance like any other final payment.

SECTION 4: RECAPTURE OF UNAUTHORIZED ASSISTANCE TO BORROWERS

9.12 OVERVIEW

To ensure that borrowers do not benefit from unauthorized assistance at the expense of others who truly need and qualify for such assistance, the Agency seeks to recover all unauthorized assistance from borrowers. The Agency has established a set of detailed procedures that Loan Servicers must follow in each case of unauthorized assistance.

9.13 REQUIREMENTS FOR COLLECTING UNAUTHORIZED ASSISTANCE *[7 CFR 3560.705]*

The Agency has the authority to recapture unauthorized assistance from borrowers, subject to the following terms and conditions:

- The amount due will be the amount stated in the notice letter;
- If a borrower agrees to repay the money in a lump sum, the Loan Servicer may allow a reasonable period for the borrower to arrange for repayment; and
- When the borrower cannot repay the unauthorized assistance in a lump sum but will repay over a period of time, the Loan Servicer may charge interest at a reasonable rate established by the Agency.

In determining whether to recapture unauthorized assistance, the Agency will consider:

- The cost effectiveness of recapture efforts relative to the amount of unauthorized assistance to be repaid;
- The availability of records to support the Agency's unauthorized assistance determination;
- Any applicable Federal, state, or local statute of limitations;
- Whether the unauthorized assistance resulted from the provision of inaccurate or false information knowingly or fraudulently provided by the borrower or tenant; and
- The ability of the borrower or tenant to repay.

9.14 AGENCY RECAPTURE OF UNAUTHORIZED ASSISTANCE

A. Overview

To collect unauthorized assistance, Loan Servicers must follow the following steps described in subparagraph 9.14 A.1 through A.5:

1. Coordination With OGC

In each case of unauthorized assistance, Loan Servicers need to work with OGC to determine the appropriate statute of limitations before making a decision to collect.

2. Notification to Recipient

Steps for Recapturing Unauthorized Assistance from Borrowers

- Coordination with OGC
- Notification to recipient
- Recipient response and Agency follow-up
- Collection
- Restriction on Loan Servicer's actions

The Agency will seek to collect unauthorized assistance from borrowers, up to the applicable statute of limitations for any particular amount of unauthorized acceptance. Normally, however, the Agency will not go back more than one year in the pursuit of unauthorized assistance unless the amount is sufficiently large to justify such action. The Loan Servicer will initiate collection efforts in the notice described in the Section 3 of this chapter. The Loan Servicer mails the notice to the recipient by certified mail, with a copy to the State Director and, for a case identified in an OIG audit report, a copy to the OIG office that conducted the audit and the Planning and Analysis staff of the National Office. The Loan Servicer will send the notice to all recipients who received unauthorized assistance, regardless of the amount. Generally, unauthorized assistance is not aggressively pursued beyond this notice if the amount is less than $1,000.

3. Recipient Response and Agency Follow-Up

When the recipient does not agree with the Agency's determination, or if the recipient fails to respond to the initial letter within 30 days, the Loan Servicer will notify the recipient of the following in a second certified letter:

- The amount of assistance finally determined by the Agency to be unauthorized;
- A statement of further actions to be taken by the Agency; and
- The recipient's appeal rights.

As with the first notice, the Loan Servicer sends copies of the letter to the State Director and, for a case identified in an OIG audit report, the OIG office that conducted the audit and the Planning and Analysis staff of the National Office.

4. Collection

If the recipient does not prevail in an appeal, or when an appeal is not made during the time allowed, the Loan Servicer will proceed with either liquidation or legal action to enforce collection. If during the course of the appeal the appellant decides to agree with the Agency's findings or is willing to repay the unauthorized assistance, the Loan

Servicer will either continue to service the account or accept full payment, subject to all applicable prepayment requirements, as appropriate.

The Agency will allow a "reasonable period" for repayment of unauthorized assistance in a lump sum, although this will usually not exceed 90 days. If lump sum payment is not feasible, the Loan Servicer may propose a repayment schedule on an exception basis.

5. Restriction on Loan Servicer's Actions

When the Loan Servicer is the same person who approved the unauthorized assistance, the State Director must review the case before further actions are taken by the Loan Servicer.

B. Procedures for Collection of Unauthorized Assistance

Following the final Agency determination of unauthorized assistance, Loan Servicers must take the following steps:

- Notify the St. Louis Office of necessary account adjustments; and

- Restructure accounts so that all money owed is collected and no borrowers are receiving assistance to which they are not entitled. This is normally accomplished on a case-by-case basis, with appropriate involvement of the management agent and tenant in cases where the tenant receives unauthorized assistance. Otherwise, it is accomplished on a case-by-case basis for repayment by the borrower in 3 months or less. Upon demand, borrowers must repay any unauthorized rental assistance and/or return on investment; sometimes this may be achieved through a workout agreement with the Agency. If 3 months is not a feasible timeframe for complete repayment, the State Director can make an exception where justified.

The specific procedures to be followed in each case will depend on the reason for the unauthorized assistance (i.e., borrower error or Agency error). The procedures associated with each cause of unauthorized assistance are discussed below.

1. Borrower Error

- If the borrower assigned rental assistance incorrectly even though the tenant correctly reported income and household size, the borrower will first notify the Loan Servicer. If the Loan Servicer verifies that the error was made based on information that was available at the time the unit was assigned, the borrower or management agent will give the tenant a 30-day written notice that the unit was assigned in error and that the rental assistance benefit will be canceled effective on the next monthly rental payment due after the end of the 30-day notice period. The written notice will provide that: the rental assistance will be assigned to the next eligible household based on *Form RD 3560-29,* from which the original priority was established when the unit was erroneously assigned. The rental assistance will not be retroactive unless

the reassignment was based on an appeal by the tenant. Retroactive rental assistance may not exceed the project's remaining rental assistance obligation balance; and

- Restitution for unauthorized rental assistance that is the borrower's fault will be handled as a refund.

Exhibit 9-1 lists the specific actions that Loan Servicers must take to attempt to recapture unauthorized assistance to borrowers.

Exhibit 9-1

Loan Servicer Actions to Recapture Unauthorized Assistance to Borrowers

Specific Agency actions to be taken in order to recapture unauthorized assistance in cases of borrower error include the following:

- Notify the borrower of the Agency's finding in *Handbook Letter 301 (3560), Servicing Letter #1*. Include in the letter a specific dollar amount and timeframe for response (usually 15 days);
- Allow the borrower time to review the finding;
- If the borrower concurs with the finding and agrees to repay the unauthorized amount, require repayment within 90 days. Note that repayment can only come from project funds if the project benefited from the unauthorized assistance;
- If the borrower does not respond to the first letter within 15 days, send *Handbook Letter 302 (3560),* S*ervicing Letter #2*. Schedule a meeting and state that a response is required within 15 days;
- If there is no response by 5 days after the deadline established in the second non-compliance letter, send a third and final letter *Handbook Letter 303 (3560), Servicing Letter #3*. This letter should include a final demand and a description of the collection and enforcement action(s) the Agency plans to take if there is no response;
- After the third letter is sent, the amount due becomes an audit receivable in 15 days. Make necessary changes to AMAS, and make arrangements to collect the unauthorized amount (no "netting" is authorized on this amount);
- Borrowers have until 5 days before the deadline for collection to appeal the Agency's decision;
- If there is still no acceptable response from the borrower, file a problem case report with the State Director. This report will recommend specific actions that should be taken to enforce compliance (e.g., acceleration, suing for performance, replacement of management agent); and
- Unauthorized assistance received due to borrower fraud will not be repaid from project funds.

2. Agency Error

There are several types of Agency error that may result in unauthorized assistance. The most common include:

- Use of incorrect interest rate;
- Assignment of unauthorized rental assistance;
- Improper issuance of interest credit;
- Non-application of recoverable cost changes;
- Approving a loan for ineligible purposes; and
- Other errors (e.g., failure to apply use restrictions).

Exhibit 9-2 describes the actions that Loan Servicers must take to attempt to recapture unauthorized assistance in the event of Agency error.

Exhibit 9-2

Actions to Recapture Unauthorized Assistance due to Agency Error

Specific Agency actions to be taken in order to correct cases of Agency error include the following:

- Identify the mistake and the amount of assistance involved;
- Provide notice to the borrower of the Agency's intent to correct its mistake and collect the unauthorized amount. This notice will include a description of where corrections to documents are required, if applicable;
- Contact OGC for advice if needed;
- Request repayment based on OGC advice regarding the feasibility of collection and any applicable collection threshold. The State Director retains the authority to decide not to pursue any unauthorized amounts below the collection threshold. If the unauthorized amount is above the collection threshold, no OGC review is required;
- Take all appropriate actions to correct the original error that led to the unauthorized assistance, and negotiate terms of repayment (if applicable) with the borrower; and
- If there is no response from the borrower, follow the procedures outlined in Exhibit 9-1.

9.15 REPAYMENT METHODS

Repayment of unauthorized assistance may be accomplished by voluntary repayment from the borrower, full prepayment, or offsets. The best approach will depend largely on case-specific circumstances.

9.16 FULL PREPAYMENT

If full prepayment is determined to be the optimal servicing solution, the Agency will accept the prepayment in accordance with applicable requirements under 7 CFR part 3560, subpart N. Prepayment would be the best solution if the action would not result in tenants being displaced such that they could not find comparable housing elsewhere in the community at rental rates of 30 percent of income or less, and if there would be no adverse impact to low- or moderate-income housing stocks for majority or minority segments of the community. Appropriate restrictive-use provisions, if applicable, must remain in the deeds of release following prepayment.

SECTION 5: RECAPTURE OF UNAUTHORIZED ASSISTANCE TO TENANTS

9.17 OVERVIEW

Section 4 of this chapter addressed the requirements and procedures for recapturing unauthorized assistance from borrowers. The Agency also established requirements that borrowers identify and collect unauthorized assistance from tenants. This section addresses those requirements and procedures.

9.18 REQUIREMENTS FOR COLLECTION OF UNAUTHORIZED ASSISTANCE TO TENANTS *[7 CFR 3560.708]*

Any assistance resulting from misrepresentation of tenant income or status that varies from the allowable amounts set forth under the occupancy requirements is unauthorized and must be repaid. Borrowers who discover that unauthorized assistance has been granted to a tenant have primary responsibility for attempting to recapture it, although the Agency may provide assistance, when needed, at its discretion.

When a tenant moves out of a property, the borrower is no longer responsible for collecting the unauthorized assistance. At that point, the Agency has primary responsibility to collect at its discretion and it accordance with the Debt Collection and Improvement Act.

9.19 PROCEDURES FOR COLLECTION OF UNAUTHORIZED ASSISTANCE TO TENANTS

If it appears that the tenant has knowingly misrepresented household status to the borrower, the Loan Servicer will look into the case to determine the facts. If the Loan Servicer determines that income or number of occupants was misrepresented, they will direct the borrower to demand and to attempt to recoup improperly received rental assistance from the tenant.

The borrower will provide the tenant with a notice of intent to recapture unauthorized assistance. The notice informs the tenant of the amount improperly advanced and the lump sum or monthly amount that will be added to the tenant's rent to recapture the unauthorized rental subsidy. The borrower will inform the Agency of the unauthorized benefits and of the agreement made by the tenant to repay.

Money collected will be remitted and processed through AMAS. The rental assistance will be credited to the rental assistance account. If the tenant fails to make restitution, the Loan Servicer will refer the case to the State Director, who will request the advice of OGC on further action.

Tenants whose rental assistance benefit will be canceled due to mistaken assignment of the benefit by the borrower/management agent must receive 30 days written notice. In such cases, Loan Servicers must insure that borrowers grant tenants the chance to cancel their lease or appeal the decision.

Exhibit 9-3 outlines the steps that must be taken by Loan Servicers and borrowers to recapture unauthorized assistance from tenants.

Exhibit 9-3

Actions to Recapture Unauthorized Assistance from Tenants

The following steps should be taken by the borrower to correct cases of unauthorized assistance due to tenant error:

- If the Agency determines that a tenant misrepresented income or the number of occupants in the unit and has received unauthorized assistance, the Agency will direct the borrower to recapture the improperly received rental assistance;
- The borrower may review the Agency's finding. The borrower may either confirm that the Agency's finding is correct, provide evidence that the problem has been corrected, or note that the tenant disputes the finding;
- If the borrower agrees with the Agency's finding and discovers the source of the unauthorized assistance, the borrower will provide a notice of lease violation to the tenant and provide an opportunity for repayment;
- The borrower and tenant will negotiate the repayment terms. If the tenant refuses or is unable to repay, the borrower will initiate eviction proceedings. The Agency will provide support as needed through this process;
- The borrower will notify the Agency of the actions taken in response to the problems cited (e.g., repayment, agreed-upon date for repayment, eviction) as well as a plan for additional actions (with time frame). These should be added to the case file;
- If either the borrower or the tenant dispute the Agency's finding, they may provide evidence for consideration by the Agency. OGC assistance may be required to review and interpret these submissions; and
- If tenant has moved out of the unit, the borrower must turn over relevant tenant records upon request (e.g., tenant move-out form).

SECTION 6: OFFSETS

9.20 GENERAL OFFSET REQUIREMENTS

Offsets are a process by which delinquent debts are collected from borrowers, grantees, or tenants through means other than a direct payment. Offsets are normally implemented only when the Agency considers the delinquent debits to be otherwise uncollectable. Loan Servicers rarely make the "uncollectable" determination; this task normally falls to regional attorneys or investigators.

Offsets must not interfere with or defeat the purpose of Agency programs, and will be used only where feasible and in the best interest of the Government. Exhibit 9-4 lists the general procedures that Loan Servicers must follow when implementing offsets.

9.21 ADMINISTRATIVE OFFSETS

Administrative offset is a process whereby other Federal agencies owing money to a borrower, grantee, or tenant pay the Agency rather than the party to which the money is owed. The following steps must be taken by Loan Servicers when implementing administrative offsets:

- Give the borrower notice through a formal letter, afford the borrower all applicable rights, and accelerate the account before asking another agency to offset any amount of debt; and

- Cancel promptly (i.e., within 30 to 90 days) administrative offset requests to other agencies if for any reason the Agency is no longer entitled to such offset.

Exhibit 9-4
General Procedures for Implementing Offsets

- **Only pursue offset when appropriate.** Avoid using offset to collect a debt more than 6 years after the right to collect the debt first accrued, unless the delay resulted from facts that were not known and could not reasonably have been known. Do not pursue offset against a claim that has been accrued for more than 10 years under any circumstances;
- **Notify borrowers of intent to use offsets.** Notify borrowers of the Agency's intent to use offset procedures. If the borrower requests a meeting to discuss the matter, schedule the meeting and advise the borrower of the date, time, and place;
- **Inform borrowers of their rights.** Inform borrowers that they have 15 days after receipt of notification to inspect/copy records, and 30 days to either make a written submission, request a meeting, or appeal. Inform borrowers of when and where records may be inspected and/or copied within 10 days of the request to do so;
- **Respect borrowers' rights.** Ensure that borrowers' rights are respected (e.g., the right to inspect and copy records, the right to avoid offset by paying debts in full within 30 days, the right to present reasons why offset should not be used, the right to request meetings with the decision-making official, and the right to appeal the decision);
- **Communicate effectively with borrowers.** Make decisions promptly, within 15 days, after a meeting with a borrower and communicate them in writing to the borrower. If a request from a borrower not to use offset is denied, the letter communicating that decision should advise the borrower of their rights to appeal to the National Appeals Division;
- **Follow appropriate hearing procedures.** Inform borrowers that they may request a hearing if they dispute any Agency finding. Hearings can include consideration of any issues concerning the debt that the borrower wishes to raise. Respond promptly to all written or oral requests or presentations made by borrowers;
- **Make appropriate refunds.** Make refunds within 45 days if it is determined that an amount should not have been offset or if the borrower wins an appeal;
- **Credit collections to borrower's account.** Process amounts collected through offset as regular payments that are credited to the borrower's account; and
- **Report to State Administrative Officer.** Consolidate and forward all information on borrowers referred for and/or collected through offsets to the State Administrative Officer within 5 days after the end of each quarter. The State Administrative Officer then consolidates the local reports and forwards that information to the St. Louis Office within 10 days after the end of the quarter.

9.22 SALARY OFFSETS

When the Agency uses salary offsets, payment for the debt is deducted from the employee's pay and sent directly to the creditor agency. Exhibit 9-5 presents the procedures that Loan Servicers must follow when implementing salary offsets.

Exhibit 9-5

Procedures for Implementing Administrative Offsets

- **Determine feasibility of salary offset**. Decide on a case-by-case basis whether salary offset is feasible.
- **Develop a payment schedule**. Schedule installment payments to liquidate the debt in approximately three years, if possible. Certifying Officials are responsible for determining the size and frequency of the deductions, which must be reasonable given the size of debt and ability to pay. Installment deductions will generally be made over a period no longer than the anticipated period of employment.
- **Set offsets at a reasonable amount**. Ensure that no more than 15 percent of an employee's disposable pay will be offset per pay period unless such an arrangement is agreed to by the employee.
- **Provide key information to borrower's employer**. Certify the following to the borrower's employing agency when requesting initiation of salary offset: that debt in a certain amount exists, that proper offset procedures have been followed, and that actions required by the Debt Collection Act have been taken.
- **Notify borrower of planned offsets**. Make notification of salary offset to the borrower at least 30 days before it is to begin. Ensure that the evidence used to make the decision to notify the borrower is sufficient for the Agency to proceed at a hearing.
- **Follow appropriate hearing procedures**. Arrange for a Hearing Officer and notify the employee of the time and place of the hearing whenever accepting a petition for a hearing regarding salary offset. The Hearing Officer will issue a written decision no later than 60 days after the filing of the petition requesting the hearing unless the employee requests and the Certifying Official grants a delay in the proceedings. Both the employee and the Agency will receive a copy of the Hearing Officer's decision.
- **Report to Field Offices**. Notify Field Offices of payments received from salary offset by providing a transaction record from the St. Louis Office.
- **Initiate cancellation procedures at the appropriate time**. Complete *Form AD-343, Payroll Action Request,* and send it to the National Office if a borrower's name has been submitted to another agency for offset and the borrower's account is brought current or otherwise satisfied. The National Office will notify the paying agency that the borrower is no longer delinquent or indebted, and advise them to cancel the offset.

9.23 IRS OFFSETS

Internal Revenue Service (IRS) offsets are a process by which the IRS can reduce a taxpayer's refund by the amount of any legally enforceable debt owed to a Federal agency. The following procedures should be followed by Loan Servicers when considering implementing IRS offsets:

- Screen the accounts of all borrowers potentially eligible for IRS offset. The St. Louis Office should take the lead, but Field Offices will further screen the accounts based on ineligibility criteria; and

- Credit the borrower's account for the amount required after IRS effects an offset and notify the appropriate Field Office. The Finance Office will take the lead; it may deduct an amount equal to the IRS's processing costs from the amount offset.

SECTION 7: CONTINUATION OF LOAN ACCOUNTS

9.24 OVERVIEW

The Agency realizes that it would be counterproductive to liquidate the account of each borrower that receives unauthorized assistance. Thus, a much more common scenario is to continue the loan account with a stipulation that some or all of the unauthorized assistance will be collected, either immediately or over time. This way, the Agency can continue to meet the needs of low-income tenants while still responsibly protecting the taxpayers' interest in the RHS portfolio.

9.25 REQUIREMENTS FOR CONTINUATION OF LOAN ACCOUNTS *[7 CFR 3560.707]*

If a recipient of unauthorized assistance is willing to pay the amount in question but cannot repay within a reasonable period of time, the Agency may continue to service the account if the recipient has the legal and financial capabilities to continue.

When the borrower is responsible for the circumstances causing the assistance to be unauthorized, the borrower must take appropriate action to correct the problem. When unauthorized assistance is due to Agency actions, the Agency will take appropriate action to correct the problem. When circumstances resulting in a determination of unauthorized assistance cannot be corrected, the Agency may, at its discretion, decide that continuation on existing terms is appropriate.

9.26 AGENCY DECISION TO CONTINUE ACCOUNT

If a recipient is willing to pay the amount in question but cannot repay within a reasonable period of time, the Agency has the option of continuing to service the account. The Agency will take appropriate servicing actions to continue the account if all of the following conditions are met:

- The recipient did not provide false information;
- Requiring prompt repayment of the unauthorized assistance would be highly inequitable; and
- Failure to collect the unauthorized assistance in full will not adversely affect the Agency's financial interest.

9.27 SERVICING OPTIONS IN LIEU OF LIQUIDATION OR LEGAL ACTION TO COLLECT

When the conditions for continuation of the account are met, the Loan Servicer will service an unauthorized loan or grant, provided the recipient has the legal and financial capabilities to continue. Agency actions will depend on whether the case involves an active or inactive borrower or grantee and the type of unauthorized assistance received.

A. Agency Actions

Generally, borrower accounts need to be restructured so that the Agency collects all money due it and so that no borrower is receiving assistance to which they are not entitled. The Loan Servicer accomplishes this result through the account adjustments described below. In most cases requiring such corrective actions, the Loan Servicer reports to the State Director, who often consults with OGC on further actions.

B. Notice of Determination When Agreement is Not Reached

If the recipient does not agree with the Agency determination of unauthorized assistance or does not respond to the initial letter within 30 days, the Loan Servicer must send a second certified letter (to the same recipients) specifying the final amount determined by the Agency to be unauthorized, further actions to be taken by the Agency, and the recipient's appeal rights.

C. Reporting to OIG

At prescribed intervals, the St. Louis Office will report to OIG on the status of cases involving unauthorized assistance which were identified by OIG in audit reports. The St. Louis Office will determine the amounts to be reported to OIG after account servicing actions have been completed. For reporting purposes, the procedures outlined below apply.

1. Unauthorized Loan

When a borrower repays an unauthorized loan account in full, Loan Servicers should include that payment in the next scheduled report only. When the Agency approves continuation with the loan on existing terms, Loan Servicers will report the case as resolved on the next scheduled report. No further reporting is required.

2. Unauthorized Subsidy

For unauthorized subsidy cases, after the borrower has repaid the unauthorized amount or payments have been reversed and reapplied at the correct interest rate, Loan Servicers should include the unauthorized subsidy as resolved in the next scheduled report. No further reporting is required.

3. Liquidation Pending

When the Agency establishes an account with liquidation action pending, Loan Servicers will include the status in each scheduled report until the liquidation is completed or the account is otherwise paid in full.

4. Liquidation Not Initiated

When liquidation is not initiated, Loan Servicers should report so in the next scheduled report, along with collections (if any). No further reporting is required.

5. Unauthorized Grant

When unauthorized grant assistance is scheduled to be repaid, the collections and status reported by the State Office to the St. Louis Office by memorandum are included in the OIG report until the account is paid in full.

6. Inactive Borrower

When an inactive borrower has agreed to repay unauthorized assistance, Loan Servicers will report the account initially, and include collections and status in each scheduled report until the account is paid in full.

D. Quarterly Reporting to the State Office

The Loan Servicer will report to the State Office by the first day of March, June, September, and December of each year the repayment of unauthorized rental assistance by account name, case number, account code, audit report number, finding number, date of claim, amount of claim, amount collected during period, and balance owed at the end of the reporting period. The State Office will forward a consolidated report to the St. Louis Office no later than the fifteenth day of March, June, September, and December of each year for inclusion in the OIG report.

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SECTION 8: ENFORCEMENT

9.28 OVERVIEW

If all of the Agency actions described in this chapter fail to result in an acceptable resolution to the unauthorized assistance, enforcement actions may be considered. Most enforcement actions will require close coordination with OGC, which will develop the Agency's enforcement approach based on information supplied by Loan Servicers. It is the Agency's goal to resolve most unauthorized assistance cases before they reach this stage.

9.29 AGENCY ACTIONS FOR ENFORCEMENT AGAINST RECIPIENTS OF UNAUTHORIZED ASSISTANCE

If a recipient is unwilling or unable to arrange for repayment, or continuation is not feasible, the Agency may take one of the following actions, as appropriate.

A. Liquidation

In the case of an active borrower with a secured loan, the Loan Servicer will attempt to have the recipient liquidate voluntarily subject to compliance with prepayment requirements. If the recipient agrees, Loan Servicers will document the agreement with an entry in the running record of the case file.

Where real property is involved, the Loan Servicer will prepare a letter to be signed by the recipient agreeing to voluntary liquidation. If the recipient does not agree to voluntary liquidation, or agrees but is unable to accomplish it within a reasonable period of time (usually not more than 90 days), the Agency will initiate forced liquidation action, unless the amount of unauthorized assistance outstanding totals less than $1,000 or it can be clearly documented that it would not be in the best financial interest of the Government to force liquidation. If a borrower meets either of the two criteria to forego forced liquidation, the Agency will make all necessary account adjustments without the recipient's signature and notify the recipient by letter of the actions taken.

B. Legal Action to Enforce Collection

In the case of a grantee, inactive borrower, or active borrower with an unsecured loan (e.g., collection-only or unsatisfied balance after liquidation), the Loan Servicer will document the facts in the case file and submit it to the State Director, who will request the advice of OGC on pursuing legal action to effect collection. The State Director will tell OGC what assets, if any, are available from which to collect. The State Director will forward the case file, recommendation of the State Director, and OGC comments to the National Office for review and authorization to implement recommended servicing actions.

C. Double Damages

1. Action to Recover Assets or Income

The Agency may request to the Attorney General to bring an action in a U.S. district court to recover any assets or income used by any person in violation of the provisions of a loan made by the Agency under this section or in violation of any applicable statute or regulation.

For the purposes of this section, use of assets or income in violation of the applicable loan, statute, or regulation includes any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project or for which the documentation has not been maintained in accordance with the requirements of the Agency and in reasonable condition for proper audit.

For the purposes of this section, the term "person" means:

- Any individual or entity that borrows funds in accordance with programs authorized by this section;
- Any individual or entity holding 25 percent or more interest in any entity that the Agency funds in accordance with programs authorized by this section; and
- Any officer, director, or partner of an entity that borrows funds in accordance with programs authorized by this section.

2. Amount Recoverable

In any judgment favorable to the United States entered under this subsection, the Attorney General may recover double the value of the assets and income of the project that the court determines to have been used in violation of the provisions of a loan made by the Agency under this section or any applicable statute or regulation, plus all costs related to the actions, including reasonable attorney and auditing fees.

Notwithstanding any other provisions of law, the Agency may use amounts recovered under this section for activities authorized under this section, and such funds must remain available for such use until expended.

3. Time Limitation

Notwithstanding any other provisions of law, an action under this section may be commenced at any time during the six-year period beginning on the date that the Agency discovered or should have discovered the violation of the provisions of this section or any related statutes or regulations.

4. Continued Availability of Other Remedies

The remedy provided in this section is in addition to—not in substitution of—any other remedies available to the Agency or the United States Government.

D. Equity Skimming

1. Criminal penalty

Whoever, as an owner, agent, employee, or manager, or is otherwise in custody, control, or possession of property that is security for a loan made under this title, willfully uses, or authorizes the use, of any part of the rents, assets, proceeds, income, or other funds derived from such property, for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title or the regulations adopted pursuant to this title, must be fined under title 18, United States Code (USC), or imprisoned not more than five years, or both.

2. Civil sanctions

An entity or individual who as an owner, operator, employee, or manager, or who acts as an agency for a property that is security for a loan made under this title where any part of the rents, assets, proceeds, income, or other funds derived from such property are used for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title of the regulations adopted pursuant to this title, must be subject to a fine of not more than $25,000 per violation. The sanctions provided in this paragraph may be imposed in addition to any other civil sanctions or civil monetary penalties authorized by law.

E. Civil Monetary Penalties

1. Overview

The Agency may, after notice and opportunity for a hearing, impose a civil monetary penalty in accordance with this section against any individual or entity, including its owners, officers, general partners, limited partners, or employees, who knowingly and materially violate, or participate in the violation of, the provisions of this title, the regulation issued by the Agency pursuant to this title, or agreements made in accordance to this title by:

- Submitting information to the Agency that is false;
- Providing the Agency with false certifications;
- Failing to submit information requested by the Agency in a timely manner;
- Failing to maintain the property subject to loans made under this title in good repair and condition, as determined by the Agency;

- Failing to provide management for a project that received a loan made under this title that is acceptable to the Agency; and

- Failing to comply with the provisions of applicable civil rights statutes and regulations.

2. Amount

The amount of a civil penalty imposed under this section must not exceed the greater of twice the damages the Agency or the project that is secured for a loan under this section suffered or would have suffered as a result of the violation, or $50,000 per violation.

In determining the amount of a civil monetary penalty under this section, the Agency must take into consideration:

- The gravity of the offense;

- Any history of prior offenses by the violator (including offenses occurring prior to the enactment of this section);

- Any injury to tenants;

- Any injury to the public;

- Any benefits received by the violator as a result of the violation;

- Deterrence of future violations; and

- Such other factors as the Agency may establish by regulation.

3. Payment of Penalties

No payment of a penalty assessed under this section may be made from funds provided under this title or from funds of a project that serve as security for a loan made under this title.

4. Remedies for Noncompliance

If a person or entity fails to comply with a final determination by the Agency imposing a civil monetary penalty, the Agency may request the Attorney General of the United States to bring an action in an appropriate district court to obtain a monetary judgment against such an individual or entity and such other relief as may be available. The monetary judgment may, at the court's discretion, include attorney's fees and other expenses incurred by the United States in connection with the action.

In an action under this paragraph, the validity and appropriateness of a determination by the Agency imposing the penalty must not be subject to review.

5. Conditions for Renewal Extension

The Agency may require that expiring loan or assistance agreements entered into under this title must not be renewed or extended unless the owner executes an agreement to comply with additional conditions prescribed by the Agency, or executes a new loan or assistance agreement in the form prescribed by the Agency.

F. Money Laundering

The Agency will act in accordance with USC Title 18, part I, chapter 95, section 1956(c)(7)(D).

G. Obstruction of Federal Audits

The Agency will act in accordance with USC Title 18, part I, chapter 73, section 1516(a).

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CHAPTER 10: COMPLIANCE VIOLATIONS, DEFAULTS, AND WORK-OUT AGREEMENTS
[7 CFR 3560.453]

10.1 INTRODUCTION

When routine monitoring of projects reveals noncompliance with program requirements, the Field Office must take immediate steps to notify the borrower and state of the need for timely corrective actions. To protect the security value of a property, it is in the Agency's best interest to work with the borrower to resolve any compliance violations. Resolving situations of noncompliance is the main subject of this chapter.

Loan Servicers should be firm in dealing with the borrower or the borrower's representative in matters of compliance violations. Because the management agent is not the party ultimately responsible for the loan, it is imperative that the borrower be directly apprised of and fully understands the consequences of default. Therefore, whenever any written servicing notice is sent to a management agent who is not the borrower, the borrower must also receive a copy of the notice. Loan Servicers need to employ courtesy, cooperation, and sound judgment when interacting with borrowers and management agents in any servicing situation.

A noncompliance situation is often resolved or deterred through a work-out agreement. This is a plan for resolving or deterring noncompliance that is developed and presented by a borrower to the Agency for approval. The Agency may or may not approve the proposed work-out agreement. This chapter discusses the Agency requirements for work-out agreements.

10.2 ADDRESSING COMPLIANCE VIOLATIONS AND DEFAULTS

Borrowers are in default of their loan or grant agreements whenever they are not in compliance with the terms of the loan or grant agreement. Such defaults may be of a monetary nature, such as when borrowers do not make their loan payments, or of a nonmonetary nature, such as when borrowers have not maintained projects properly. Default may be triggered by events that are beyond the borrower's control, such as changing markets that lead to prolonged vacancies. Nevertheless, being in default is a serious situation for a borrower and requires that every effort be made to resolve it.

Defaults may lead to foreclosure and loan liquidation. One significant step that can be taken toward resolving the default is for the Agency and the borrower to agree to a work-out agreement. A work-out agreement may also be used in certain cases to avert a default situation. The Agency will not pursue enforcement against a borrower in default (monetary or nonmonetary) if an approved work-out agreement is in place and on schedule. Thus, it is in the borrower's best interest to work with the Agency to resolve compliance issues through a work-out agreement.

A work-out agreement is a proposal that is submitted by the borrower to the Agency for approval of changes in project operations, for additional time to restore compliance, or for servicing actions to assist in correcting identified deficiencies. There are several servicing

options available under a work-out agreement, and the borrower and Loan Servicer should consider all of them and evaluate which are the most appropriate for a specific problem project.

This chapter explains how borrowers may enter into default of their loan or grant agreement and the different types of defaults that may occur. It describes the process by which the Loan Servicer notifies the borrower of compliance violations and the options available to remedy the noncompliance. The chapter then discusses work-out agreements and includes a separate section on Special Note Rents (SNRs), which enable borrowers to reduce rents to attract tenants. By reading this chapter, the Loan Servicer will understand how to systematically work with the borrower to resolve noncompliance, when it is appropriate and feasible for a borrower to enter into a work-out agreement, what are the required terms of the agreement, and how to monitor borrower compliance with the work-out agreement.

SECTION 1: TYPES OF DEFAULTS *[7 CFR 3560.452]*

10.3 OVERVIEW

Borrowers in violation of the terms of the loan or grant documents for the project or applicable Federal regulations, including a work-out agreement, who fail to fully correct a deficiency by a date specified by the Agency in a written notice are in default of their loan or grant documents.

Defaults can be of a monetary or nonmonetary nature. The Agency will initiate appropriate enforcement actions against any borrower in default.

10.4 MONETARY DEFAULT

A project that is in monetary default is defined as one that is delinquent for more than 60 days. Projects with monetary violations include those for which the loans have been accelerated and of which the borrowers are in bankruptcy. A project is delinquent when a loan payment is more than 10 days past due. Project payments are due on the date specified on *Form RD 3560-52, Promissory Note*.

Monetary default may warrant the development of a work-out agreement or initiation of enforcement actions by the Agency that include termination of a management agreement, receivership, suing for performance, collection of unauthorized assistance, or denial of a rent increase.

10.5 NONMONETARY DEFAULT

Nonmonetary defaults include, but are not limited to, failing to maintain project reserves, failing to adequately maintain the physical condition of the property, failing to comply with environmental mitigation measures, occupying units with ineligible tenants without prior Agency approval, charging incorrect rents, failing to meet fair housing requirements, and failing to properly report to the Agency. A borrower will be considered in nonmonetary default if the identified deficiencies are not cured within 60 days of notification.

Attempts to resolve nonmonetary defaults should be handled whenever possible at the Field Office level with appropriate guidance and assistance from the State Office. Environmental concerns, such as failure to comply with mitigation measures, should be reviewed with the State Environmental Coordinator for further guidance. The State Director should counsel with the Office of General Counsel (OGC) for advice, if needed, in servicing those cases where nonmonetary defaults cannot be resolved at the Field Office level. These actions may include liquidation of the account (see Chapter 12).

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SECTION 2: CONDITIONS OF CONCERN, COMPLIANCE VIOLATIONS, AND DEFAULTS

10.6 AGENCY CLASSIFICATION SYSTEM

The Agency has developed a classification system that describes the servicing status of each operational multi-family housing project. This classification system provides a picture of the status of the housing portfolio and flags those projects that need special servicing and/or monitoring. Exhibit 10-1 shows how projects are classified.

The Agency's classification system is to be used to focus servicing efforts. Projects classified as a D or a C should receive first priority when allocating resources to address portfolio concerns. Internal supervisory reviews should primarily examine how Loan Servicers are working to address projects with servicing concerns.

The classification system will be maintained on the Multi-Family Integrated System (MFIS). Servicing officials are responsible for making sure that MFIS is current and accurately reflects a project's servicing status. The supervisory visit and engagement review are key events for updating a project's servicing status. Chapter 9 of HB-2-3560 describes the Agency review process in more detail.

Exhibit 10-1

Classification System of Operational Projects

Class D includes:

- Projects in nonmonetary default having an unresolved violation for more than 60 days from the date of *Handbook Letter 301 (3560), Servicing Letter #1*; and
- Projects in monetary default that are delinquent for more than 60 days

Class C includes:

- Projects with an unresolved finding or violation; and
- Projects with an unresolved violation for less than 60 days from the date of *Handbook Letter 301 (3560), Servicing Letter #1*.

Class B includes:

- Projects with findings or violations with an approved work-out plan that is on schedule.

Class A includes:

- Projects with no unresolved finding or violation.

10.7 FINDINGS

A finding is determined when the Agency "finds" that a borrower is not operating in accordance with the loan or grant agreement, with Agency regulations, or with applicable local, state, or Federal laws. When the Agency discovers a deficiency in a project that requires correction but is not the equivalent of a violation or an unacceptable summary level finding during an inspection or review report, the Agency must notify the borrower of this finding. Depending on the severity of the finding, the servicing official may advise the borrower of the finding either orally, or in writing through a monitoring letter. Should the finding not be corrected after at least one written notice has been sent to the borrower with a specified date by which the finding must be corrected, the Loan Servicer must determine whether the issue should be elevated to a violation status. When the Servicing Office concludes that the finding should be viewed as a violation that could lead to a default, the Loan Servicer must begin the process of issuing the servicing letters described in Paragraph 10.10.

10.8 VIOLATIONS

A violation is a finding that the Servicing Office escalates because of its severity or because of the type of servicing effort that will be needed to obtain compliance. When the Agency designates a finding as a violation, it indicates a willingness to pursue the finding to the point of acceleration to have it corrected. Compliance violations include, but are not limited to, any unacceptable summary level finding on the physical inspection report, project management and occupancy review, or engagement review that could be updated at any time. Examples include failing to make required contributions to project reserves, failing to adequately maintain the exterior physical condition of the property under Agency standards, failing to comply with environmental mitigation measures, occupying units with ineligible tenants without prior Agency approval, charging incorrect rents, and failing to properly report to the Agency.

10.9 KEY STEPS IN ADDRESSING COMPLIANCE VIOLATIONS AND DEFAULTS

The Agency must respond quickly and systematically whenever a project is identified as being in noncompliance with program requirements. In responding to a noncompliance situation, the Loan Servicer will take some or all of the following steps and update the servicing status on MFIS:

- Notify the borrower of the violation and request corrective action;
- Meet with the borrower to discuss the problem and possible servicing actions to remedy the problem;
- Review any proposed work-out agreement developed by the borrower and suggest acceptable servicing actions if appropriate;
- Issue a problem case report; and

- Initiate enforcement actions to motivate the borrower to restore compliance.

These steps are discussed in detail in the following sections.

10.10 NOTIFICATION TO BORROWER OF SERVICING PROBLEMS

The Agency must notify the borrower using formal servicing letters that state the need for corrective action to be taken. It is not the Agency's responsibility to come up with solutions to the problems. Rather, it is the borrower who must identify what corrective actions will take place immediately or over time through a work-out agreement.

The Field Office will use a series of servicing letters to communicate with the borrower until the problem is resolved. Copies of the letters must be sent to the management agent of the property that is the subject of the letters if the owner is not the management agent. Exhibit 10-2 shows the sequencing of these servicing letters.

Handbook Letter 301 (3560), Servicing Letter #1 serves to trigger the start of a 60-day period for nonmonetary violations and a 45-day period for monetary violations, at the end of which the borrowers are in default of their loan agreement if the situation has not been resolved. Resolution may take the form of action proposed by the borrower and approved by the Agency, or it may take the form of enforcement actions instituted by the Agency when the borrower fails to respond or responds inadequately.

Attachments 10-A, 10-B, and **10-C** are examples of the servicing letters.

A. Preliminary Notification

When a borrower becomes delinquent on a payment, an automatically generated Delinquency Billing Statement is mailed to the borrower. The borrower will be in default if the loan payment is not made in full within 60 days of this notice. If the borrower does not submit the loan payment before the payment is 30 days past due, the borrower receives *Handbook Letter 301 (3560), Servicing Letter #1*. If the borrower submits the full payment, including any applicable late fees (see Chapter 4, paragraph 4.4 on late fees) the Loan Servicer does not take any further servicing action.

During an on-site monitoring visit the monitors should meet with the borrower to review the initial results of the visit, including a discussion of compliance violations. See Chapter 9, paragraph 9.6 B of HB-2-3560 for more information about on-site monitoring visits.

Example: Borrower B's project has several crumbling steps in the stairwell. Since this represents an unacceptable condition of exterior maintenance, which is a compliance violation, the Loan Servicer notifies the borrower during the on-site visit on this violation.

Exhibit 10-2

Sequence of Servicing Letters

Letter	Nonmonetary	Monetary
Preliminary Notification	The Loan Servicer informs the borrower of violations during a wrap-up meeting of a monitoring visit.	A Delinquency Billing Statement is automatically sent to borrower when the borrower becomes delinquent (10 days past due).
Letter #1	Sent upon evidence of violation and no later than 30 days after the monitoring visit. Date of letter signifies beginning of 60 day period to default.	Sent no later than when payment is 35 days past due.
Letter #2	Sent sometime after 15 days if borrower fails to respond or responds inadequately to Letter #1. Notifies borrower of date by which they will be considered delinquent if violation not corrected (60 days after date of Letter #1).	Sent after payment is 45 days past due. Notifies borrowers of date by which they will be classified a D project (60 days after payment due date).
Letter #3	Sent at least 60 days after date of first letter and at least 15 days after Letter #2 notifying borrowers that they are in default and warning of enforcement action if problem is not corrected within 15 days.	Sent 60 days after payment due date notifying borrower that the Agency will take legal action to cure the default and warning of enforcement action if payment is not made within 15 days.

B. Borrowers with Multiple Servicing Issues

If a borrower is in violation in several different areas, the *Handbook Letter 301 (3560), Servicing Letter #1* should identify all the violations. If sent, *Handbook Letter 302 (3560), Servicing Letter #2* would reference "ongoing compliance violations" to cover multiple servicing issues. The series of letters continues until each violation has been resolved.

A servicing letter may cite conditions of concern (see Paragraph 10.7) along with compliance violations. However, only the cited compliance violations could lead to a default status if left unresolved. If the borrower resolves all violations within 60 days, they will not default even if the conditions of concern have not been resolved.

If at any time the Agency discovers that a borrower who has received a servicing letter has another problem that warrants a servicing letter, the letter will be sent, triggering a second series of letters. These letters can run separately from and independent of the first series of letters or they may be combined at some point.

However, it is important that the Loan Servicer track the separate violations cited by the date of each *Handbook Letter 301 (3560), Servicing Letter #*1 so that *Handbook Letter 303 (3560), Servicing Letter #3* correctly identifies the violation that has resulted in the default by a certain date.

10.11 EVALUATING THE PROJECT

When the Loan Servicer has sent two servicing letters to notify a borrower of problems with a project, the Loan Servicer must evaluate the project to establish whether it is in the Agency's best interests to attempt to work with the borrower to preserve the subject project. The Loan Servicer will use the procedures outlined in Chapter 6. Such an evaluation should come before any meeting with the borrower so that the Loan Servicer is familiar with the project and its status.

10.12 MEETING WITH THE BORROWER

When the borrower proposes a work-out agreement in response to *Handbook Letter 301 (3560), Servicing Letter #*1, or when *Handbook Letter 302 (3560), Servicing Letter #2* must be sent, the Loan Servicer must request a meeting with the borrower. The purpose of the meeting is to identify and agree upon the servicing problem, establish the underlying causes of the problem, and begin to develop the parameters of a work-out agreement. The Loan Servicer will discuss possible Agency servicing actions.

It is the responsibility of the borrower—not the Agency—to propose and develop an acceptable work-out agreement. However, borrowers may delegate authority to their management agent to develop a work-out agreement. A borrower may do this by signing a statement in the management plan or certifying in a letter to the Agency that the management agent has the authority to act on their behalf.

Once the work-out agreement is proposed, the Loan Servicer may propose servicing actions that are appropriate and acceptable to the Agency. Section 4 of this chapter describes the special servicing actions available to Loan Servicers.

10.13 SELECTING SERVICING OPTIONS

The Agency may agree to various servicing options to resolve the compliance problems depending upon the circumstances of the noncompliance. The deciding factor will often be the quality of management.

A. Poor Management and Noncompliance with Program Requirements

Where management is poor and/or there is noncompliance with program requirements, the Agency may agree to:

- **Borrower training**. Training of resident managers may be charged as a project expense if directly related to improving project operations;

- **New management**. Hiring or changing resident managers or management agents;

- **Improving maintenance**. Change to normal, preventive, and long-term maintenance and repair programs to make the project more marketable;

- **Improving budget and record keeping, and using monthly reports**. Major expenditures should be reviewed for appropriateness; and

- **Improving outreach and marketing**. Project marketing plans, including the Affirmative Fair Housing Marketing Plan, should be reviewed and updated as appropriate.

B. Acceptable Management, but Marketability and Cash Flow Problems

Where management is acceptable, marketability and cash flow problems may be resolved through one or more of the following actions.

- Upgrading project desirability by:

  ◊ Performing necessary and preventive maintenance;

  ◊ Improving curb appeal at the project;

  ◊ Improving security for tenants, such as installing deadbolts and more lighting; and

  ◊ Improving communication between management, residents, and the community.

- Reducing expenditures by reviewing the appropriateness of operating and expense levels in relation to services rendered. It is not intended that management fees be adjusted as a condition for consideration of servicing options. Operation and expense levels may be reduced by:

  ◊ Containing operation and maintenance costs that will not disrupt project operations;

  ◊ Renegotiating contracts with suppliers of material and services; and

  ◊ Temporarily deferring noncritical maintenance, provided tenant safety and project marketability are preserved.

- Temporarily reducing or deferring reserve contribution levels.

- Increasing revenues by:

  ◊ Injecting non-project revenues;

  ◊ Requesting rental assistance; or

◊ Permitting temporary incentives to improve occupancy.

- Permitting a release of the rental assistance payments that would ordinarily go for debt service to be used for project operation and maintenance.

C. Acceptable Management, but Lack of Project Demand

Where management is acceptable, but there is a lack of project demand or a problem of obtaining and/or retaining eligible tenants, the problems may be resolved by:

- Granting occupancy waivers;

- Changing the project designation; and

- Implementing a SNR, see Section 6 of this chapter.

10.14 THE PROBLEM CASE REPORT

The Loan Servicer must develop a problem case report using *Form RD 3560-56 Report on Real Estate Problem Case* for the State Director if the Loan Servicer has sent a borrower three letters requesting corrective action to a compliance violation and the borrower has failed to provide an adequate response.

The problem case report describes the situation for the State Director and recommends enforcement action. The State Director will review the problem case report and respond to the Field Office within 30 days of receipt of the problem case report indicating the action to be taken. The State Director's response will be either:

- An agreement with the Loan Servicer's proposal for enforcement; or

- A directive for alternative servicing.

10.15 ENFORCEMENT ACTIONS

If a borrower fails to provide an acceptable work-out agreement or fails to comply with the work-out agreement, the Agency will initiate enforcement actions when liquidation is not in the Government's or the tenants' best interests. This might occur in the case of defaults that do not affect the health and safety of tenants and where the cost of liquidation is significant relative to the violation, or where the costs of liquidation and providing adequate tenant protections is high. Available enforcement actions that the Agency can take include:

- **Termination of the management agreement**. The Agency may terminate the management agreement and require the borrower to hire new management;

- **Receivership**. The Agency may appoint a third party to manage the project. When this becomes necessary, the State Director must contact OGC for assistance and provide them with alternative management agents;

- **Suing for performance under the loan document**. In such cases, the Office of General Counsel will provide assistance; and

- **Collection of unauthorized assistance**. The procedures outlined in Chapter 9 will be followed.

A. Liquidation

When it is in the Government's or the tenants' best interest to liquidate, or if enforcement actions have been unsuccessful, the Agency will initiate liquidation through either:

- Voluntary liquidation; or

- Foreclosure.

The Agency may proceed directly to liquidation if doing so will not adversely affect tenants. Normally this is reserved for cases where the borrower has abandoned the project or a partnership has been dissolved, leaving no legal entity in place to oversee the property. Properties where serious health and safety concerns exist are the most likely to go straight to enforcement or liquidation. Chapter 12 provides details on liquidation.

B. Debt Settlement

If the property is worth less than the outstanding Agency debt, it may be in the government's best interest to settle the debt using its debt settlement procedures. Compromise offers to settle outstanding debts may be part of a work-out agreement accompanying a transfer. Chapter 12 provides further details on debt settlement.

SECTION 3: DEVELOPING A WORK-OUT AGREEMENT
[7 CFR 3560.453]

10.16 OVERVIEW OF WORK-OUT AGREEMENTS

A work-out agreement is a proposal submitted by a borrower to the Agency for approval of changes in project operations, additional time to restore compliance, or other special servicing actions to assist in correcting identified deficiencies. A borrower may submit a work-out agreement at any time in response to Agency notification of compliance problems or prior to that if the borrower feels that noncompliance is imminent.

The work-out agreement may be a very simple one page plan for resolving a single problem, or it may be a more complex document of several pages that describes several plans of action to resolve a more complicated problem. If a borrower does not develop a work-out plan, the Loan Servicer must develop a problem case report, in accordance with Paragraph 10.14.

Acceptable and successful work-out agreements depend upon some flexibility on the part of the Loan Servicer and the borrower, thoughtful and project-specific servicing, and thorough and consistent monitoring that serves to track the progress of the agreement.

10.17 CONDITIONS WARRANTING A WORK-OUT AGREEMENT

Serious compliance deficiencies that cannot be resolved promptly may warrant the development of a work-out agreement. Such conditions may reflect a financial, physical, fair housing, or occupancy deficiency.

A. Financial Deficiencies

Financial deficiencies that may require a work-out agreement include:

- Inadequate cash flow to meet project needs. Cash flow should be adequate to pay Agency debt, meet reserve requirements, pay taxes, pay insurance, pay other project expenses, and pay any authorized return on owner investment when earned;

- Projects that are 60 days past due;

- Seriously underfunded reserve accounts that cannot be brought up to required levels within a normal budget cycle or where unauthorized withdrawals have been made; and

- Borrowers who have not adhered to program requirements such as paying taxes, maintaining insurance, or submitting required financial information.

B. Physical Deficiencies

Physical deficiencies that may require a work-out agreement include failure to maintain decent, safe, and sanitary housing opportunities for residents and maintenance that has been deferred for so long that it has become a financial burden to the project.

C. Fair Housing Deficiencies

Fair housing or Section 504 violations and problems with tenant certification and project occupancy requirements may warrant the development of a work-out agreement.

D. Occupancy Deficiencies

Serious vacancies that threaten property viability where management can furnish evidence that they have made efforts to increase occupancy may warrant a work-out agreement.

10.18 ELIGIBILITY FOR WORK-OUT AGREEMENTS

The Agency will consider work-out agreements only for properties:

- That are deemed to be program property; or
- Whose owners demonstrate a commitment to correcting property deficiencies.

A. Program Property

The Loan Servicer must establish whether the project is suitable for the program using the guidance provided in Chapter 6. If the project is deemed to be non-program property, a work-out agreement must not be considered.

B. Owner Evaluation

An owner who has not maintained compliance with prior work-out agreements and has historically ignored Agency requests for corrective actions must not be considered eligible for a work-out agreement.

10.19 CONTENT OF A WORK-OUT AGREEMENT

All work-out agreements must be in writing and executed by the borrower, or the borrower's designated representative, the management agent who manages the project (if different from the borrower), and the Agency before they take effect. The work-out agreement must correct all deficiencies that have been identified in a project.

Exhibit 10-3 lists the information that must be included in a work-out agreement.

10.20 CONDITIONS PLACED ON THE BORROWER

Borrowers must forgo and cannot recoup the annual return to owner for the budget year in which a work-out agreement is in effect.

Exhibit 10-3

Recommended Format for Servicing Work-out Plan (SWP)

Background information. Provide history and describe past goals and accomplishments.

Description of the problem(s) to be solved. Identify project weaknesses and needs making sure to cover:

- Compliance deficiencies (e.g., delinquent amounts, underfunded reserves, nonpayment of taxes, deferred maintenance, unacceptable tenant file records, noncompliance with accessibility and fair housing issues, etc.); and
- Serious financial concerns (e.g., high vacancies, inadequate cash flow, high Operations & Maintenance (O&M) expenses.).

Underlying causes of problem. Attempt to identify the cause of the problem. Attempt to recognize when problems identified are symptoms or the results of the same underlying causes.

Overview of plan to correct problem. Provide a summary of the plan and identification of key assumptions used in projections.

How the plan will work. Provide details on how the plan will work with attached supporting documentation (i.e., budget), when appropriate. A timetable for completing the work-out plan and key components of the plan (i.e., plan calling for capital improvements should identify the improvement proposed, cost with supporting estimates, source of funds, and completion dates).

Anticipated results. Clearly identify the goals to be reached. Have periodic, measurable interim goals to determine that full implementation is on track.

Written work-out plans. All work-out plans must be in writing and must be executed by the borrower or the borrower's designated representative, and Rural Development. A copy of the executed work-out plan will be placed in the case file; copies will be given to the borrower, management agent, and the State Director.

Time frames for implementing and completing the plan. Prior to approval, all plans must be evaluated on whether the plan realistically achieves the objectives of the loan. All plans must be reevaluated at the end of the two-year period. If the plan includes a time frame for completion of more than two years, the plan must be revised and reexecuted at the end of each year to determine if satisfactory progress has been made.

Monitoring working plans. The following statements must be a part of the plan immediately above the signatory line:

> "The management agent is responsible for making quarterly progress reports with regard to plan compliance to Rural Development and the borrower. The first report will be due no later than 100 days from the date of Rural Development approval and every 100 days thereafter."

Check appropriate box:

- ☐ Initial SWP
- ☐ Renewal of SWP
- ☐ Renegotiated SWP. There have been _____ previous SWPs on this account.

10.21 PRIORITIES IN MEETING EXPENDITURES

In developing work-out budgets for projects experiencing cash-flow difficulties, the following priorities will be used:

- First priority is to meet obligations to the prior lienholder, if any;
- Second priority is for critical project operating and maintenance expenses, including taxes and insurance;

- Third priority is for Agency debt payments;
- Fourth priority is for reserves; and
- Fifth priority is for other project needs.

10.22 LENGTH OF TERM AND AUTHORITIES

A. Term of Work-Out Agreement

The maximum term of a work-out agreement is two years. All agreements must be reevaluated annually as well as at the end of the two-year period. The evaluation is based on whether the plan realistically achieves financial viability and otherwise meets the objectives for which the loan was made. If an approved work-out agreement calls for actions that extend beyond a two-year period, borrowers must submit an updated and if necessary, revised work-out agreement to the Agency for approval. The updated work-out agreement must be submitted to the Agency 30 days prior to the expiration of the work-out agreement in effect. The Agency may reexecute the agreement if satisfactory progress has been made.

Reserve Account Deficiencies

When seriously underfunded reserve levels are involved in an extended work-out time period, the Loan Servicer should reassess the reserve level for the project and establish a new reserve level, if appropriate. A capital needs assessment can be useful to make this determination. If re-funding the reserve to its new level will require more than two years, the borrower and Loan Servicer may want to consider additional work-out terms so that the project is not in continual need of requiring a

Normally, work-out agreements should not exceed two years, especially if a plan calls for less than full payment on an Agency loan, or less than full contribution to the reserve account. Plans not meeting these criteria are normally not considered as viable and feasible.

B. Authority to Approve Work-Out Agreements

1. Field Offices

Delegated Field Office staff can approve work-out agreements that correct deficiencies within 12 months, except when the agreement includes a special servicing action per Section 4.

2. State Offices

Delegated State Office Staff approves any work-out agreements that:

- Are for longer than 12 months;
- Require reduced or zero loan payments;
- Require contributions to reserves of less than that which is required plus 10 percent of the delinquent amount; or
- Include loan adjustments or writedowns.

10.23 AGENCY REVIEW AND APPROVAL *[7 CFR 3560.453(b)]*

Work-out agreements are a tool that the Agency can use to work with the borrower to effectively resolve defaults if the borrower is acting in good faith to actively propose realistic corrective actions. Approval of a work-out agreement is not guaranteed to a borrower. Failure to approve a work-out agreement is not an adverse action by the Agency because the Agency is not required to grant approval of modifications to the terms of the loan for borrowers in default; thus, the Agency is not taking away any borrower rights by not approving the work-out agreement. Therefore, failure to approve a work-out agreement is not appealable by a borrower, although the Agency's decision may be reviewed.

A. Evaluation of Work-Out Agreement

The Agency is under no obligation to offer or agree to any special servicing actions contained within a proposed work-out agreement. In evaluating the borrower's proposal, the Agency will accept work-out agreements that meet the following criteria:

- The proposed actions effectively correct the deficiency;
- The proposed time frame for correction is reasonable and realistic for correcting the deficiency;
- There is evidence of adequate borrower commitment of resources, considering the cause of the problem, (e.g., a lesser commitment may be appropriate if the problem was caused by circumstances beyond the borrower's control);

- The proposed special servicing actions for the Agency (e.g., reamortization, writedown) is in the interest of the Government and the tenants, and the costs of continuation are not more than the costs of liquidation and providing tenant protection; and

- The proposed actions are consistent with the borrower's management plan. If the proposed actions are not consistent, the management plan must be updated.

B. Procedures Following Approval of Agreement

The approved work-out agreement will be signed and dated by the Approval Official, the borrower, and the management agent, if different from the borrower, and will be attached as an addendum to the management plan for the project.

10.24 CANCELING A WORK-OUT AGREEMENT

A work-out agreement may be canceled by whomever approved it 10 days after discovering a borrower's noncompliance with its terms. If the official who originally approved the work-out agreement is not available, then the official who has assumed that individual's responsibilities will be responsible for canceling the agreement and notifying the borrower.

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SECTION 4: SPECIAL SERVICING ACTIONS

10.25 SPECIAL SERVICING ACTIONS THAT MAY BE A PART OF A WORK-OUT AGREEMENT

A number of special servicing actions may be proposed and approved as part of a work-out agreement. As shown in Exhibit 10-4, these servicing actions may be divided into two broad categories: changes in project operations and changes to the loan account. This section describes other servicing actions, most of which are less extreme.

A. Servicing Actions to Change Project Operations

The borrower may propose one or more servicing actions that will produce a change in project operations. Some of these actions are discussed in detail in other sections.

Exhibit 10-4

Special Servicing Actions That May Be Part of an Approved Work-out Agreement

Changes in Project Operations	Changes to the Loan Account
• Rent changes and/or preparation of a new budget • Occupancy waivers • Temporary incentives to improve occupancy • Special note rents (SNRs) • Changing management agent or management plan • Changing project designation • Transfer of ownership • Substitution of partners	• Loan reamortizations • Loan adjustments (writedowns) • Loan consolidation • Deferral of payments • Prepayment/compromise offer • Providing rental assistance (if available) • Recasting the entire loan (i.e., "starting fresh")

1. Rent Changes or Preparation of a New Budget

To achieve financial stability, the borrower may propose a new budget that shows a change in rents or operation costs. In evaluating the request, it may be appropriate for the Agency to analyze the current market in which the project is located to see whether the project rents compare favorably with rents for similar properties in the market. Rent incentives will be allowed as described in paragraph 10.25 A.3 of this section, but the change and accompanying budget will be conditionally approved by the Agency subject to meeting the requirements in Agency regulations, see Chapter 7 of HB-2-3560. If the Agency receives comments from tenants that warrant a different decision from the one

made when the work-out agreement was conditionally approved, the Agency must inform the borrower of these discoveries and make any needed adjustments to the conditionally approved budget.

In reviewing these changes, the Loan Servicer must evaluate both short- and long-term budget projections so as to establish whether the project is likely to achieve its financial goals during the work-out period, and whether the project is likely to achieve and maintain financial viability in the long term. The Loan Servicer must evaluate whether projections show repayment ability after the work-out agreement objectives are met based on realistic vacancy, rent rate, and/or reamortization assumption.

Any projected capital improvements shown in the budget must be accompanied by statements that describe the work to be done, the estimated costs with supporting material, the projected time frame for completing the work, and the source of funds to be used for the improvements.

2. Occupancy Waivers

When a project is experiencing high vacancies and eligible tenants are not available, the borrower may request to temporarily solve the problem by renting to ineligible tenants. Ineligible tenants might be individuals whose incomes or family sizes are above the maximum limits or who do not meet an occupancy requirement, such as an age limit.

A request to rent to ineligible tenants may be approved by the Loan Servicer based on the following determinations:

- There are no eligible persons on the waiting list;
- The borrower has made a diligent but unsuccessful effort to rent any vacant units to an eligible tenant; and
- The borrower will continue to seek eligible tenants and will submit the following to the Field Office;
    - ◊ *Form RD 3560-29; and*
    - ◊ A report of efforts made to locate eligible tenants.

The borrower must agree to the following conditions:

- The units may be rented to ineligible tenants for no more than one year, following which the lease must convert to a monthly lease. A statement to this effect must be included in the lease;
- Tenants who are ineligible because their household income exceeds the maximum for the project will be charged the Agency-approved SNR, if applicable; and

- Without Agency approval, management may assign a larger or smaller unit than the household needs if the household is otherwise eligible. Tenants must agree to transfer to a correctly sized unit when one becomes available and must pay all costs associated with moving. A statement to this effect must be included in the lease.

3. Temporary Incentives to Improve Occupancy

The borrower may request temporary incentives to improve project occupancy. These incentives may not exceed the life of the work-out agreement. The Agency may grant such incentives when project management has been acceptable and under the following conditions:

- The project is encountering unacceptable vacancy levels.
- The incentives are short-term, modest, and consistent with program objectives.
- Recipients are given a clear understanding of the extents and limits of the incentives.
- The use of incentives is fully accounted for on project budgets and annual reports.
- Occupancy incentives will be paid from the following sources:
  - ◊ Non-project sources;
  - ◊ Forgone return to owner; and
  - ◊ Project funds when it can be shown to be cost-effective, which means that the revenues derived will outweigh the costs of providing the incentives.

Temporary Incentives to Improve Occupancy

1. Security deposit reductions or waivers and extended security deposit payment period.
2. Reduced rents in the form of rebates, coupons, or a temporary agreement.
3. Free rent.
4. Reduced or free utilities.
5. Referral fee payments.
6. Rent-up gift to tenant, such as a savings bond or gift certificate.

4. Special Note Rents

The borrower may request a SNR to reduce the note rate rent to attract tenants who can afford to pay more than 30 percent of their incomes in rent and utilities but who will not pay the existing note rate rent. This servicing action is discussed in detail in Section 6 of this chapter.

5. Changing the Management Agent or Management Plan

Where poor management is evidenced by a record of failing to comply with Agency requirements, the borrower may elect to change management. Where the Agency has notified the borrower of the need to change management, financial incentives under

work-out agreement provisions may not be approved until the borrower changes management, or agrees to change management within a reasonable time frame.

6. Changing the Project Designation

When a market has changed such that the type of tenant who would qualify for the project is no longer available and vacancies are resulting, the borrower may request a change in project designation. The State Director will consider such a change when the following information has been provided:

- The complete borrower case files will be submitted together with the Loan Servicer's specific recommendations and analysis of the present and long-term situation;

- Market feasibility documentation, which may include inquiry lists from the project or waiting lists at other nearby and similar properties, which shows that other tenants are available to occupy the project. Market feasibility documentation must also clearly indicate that the present long-term marketability of the project is significantly changed from the original market, and must include the appropriate demographic information that reflects the population trends in the area. The market feasibility documentation must also show if the demand is for the bedroom-sized units in the project or if different sized units would be more desirable;

- A summary of all servicing actions taken by the Agency to aid the borrower in maintaining the present designation;

- A summary of all actions taken by the borrower to effectively market the units to potential eligible tenants;

- A summary of the impact the change will have on any existing tenants, rent subsidy needs, and the community as a whole; and

- A summary of any needed or required physical modifications and analysis of cost feasibility to complete the modifications, including modification to unit sizes in terms of number of bedrooms.

7. Transfer of Ownership

In some cases, the only means of addressing project concerns is through replacement of the borrower. Some reasons that may require a transfer of ownership include:

- Illness or death of a borrower;

- Financial difficulties that cause a borrower to terminate his or her business operation; and

- Fraudulent activity, as determined by the Office of the Inspector General (OIG).

Where work-out agreements call for a change in the borrower, the Agency may temporarily approve financial concessions contingent upon the borrower agreeing to seek a transfer of ownership. The borrower must agree to provide evidence that ownership replacement is being actively pursued. Should ownership replacement not be achieved within an agreed-upon time frame, liquidation of the account may be appropriate.

When a transfer occurs as a result of noncompliance, the transferee (new borrower) must provide a plan for bringing the project into compliance as part of the application package. For example, the loan payments and reserve account may be behind schedule. The transferee provides a plan that identifies the source of funds to meet these conditions.

Chapter 7 provides the details on approving and processing transfers of ownership.

8. Substitution of Partners

The borrower may request a substitution of general partners as a way to inject new resources into the borrower entity. Chapter 5 provides the details on approving and processing substitution of partners.

B. Changes to the Loan Account

Proposed servicing actions may require changes to the loan account such as those that are described in Chapter 11.

1. Deferral of Payments

Deferring any debt payment to the Agency is an extreme measure that should be used as a last resort. Deferring a portion of the Agency debt and using this deferred amount to build up reserve funds may only be approved when the funds are being used to pay identified critical project needs. For example, when a roof must be replaced within the next two years, the work-out agreement may call for deferring payments in an amount equal to the cost of replacing the roof and this amount will be deposited into the reserve account. The critical need must be identified and closely monitored to ensure compliance.

Deferral of payment by the Agency should usually be accompanied by a borrower contribution of financial resources to the project.

Deferring debt payments should not exceed two years. National Office approval must be obtained when longer periods of time are justified.

2. Change of Payments

Scheduling loan payment in accordance with the borrower's repayment ability. The provisions must be documented. The issuance of *Form RD 3560-29A, Multiple Family Housing Statement of Payment Due,* will normally be suppressed during the period in which a work-out agreement calling for less than the normal full scheduled installment is effective. To suppress issuance of *Form RD 3560-29A,* process by using the appropriate

screen on the Automated Multi-Family Housing Accounting System (AMAS); see the AMAS manual for specific instructions on how this is done. Upon expiration of the work-out agreement, a review will be conducted to determine any further servicing actions that may be appropriate (e.g., reamortizing, rescheduling, executing a new servicing plan and/or supplementary payment agreement that may call for higher than normal payments, preparing a problem case report, etc.). As long as a borrower is meeting the provisions of an approved work-out agreement calling for less than full installments, late fees will be waived.

3. Prepayment

A borrower may offer to pay their loan in full, ahead of the scheduled loan repayment date and exit the program. In such an event, the project will no longer be a part of the Multi-Family Housing program, will no longer be subsidized by the Agency, and will no longer be subject to Agency regulations and procedures. Chapter 15 provides the details on approving and processing prepayment requests.

4. Voluntary Conveyance

Voluntary conveyance is a method of liquidation by which title to security is transferred to the Federal Government. The State Director is authorized to approve voluntary conveyance of property if the total indebtedness, including prior and junior liens, does not exceed their approval authority. Chapter 12 provides the details on approving and processing an offer of voluntary conveyance.

5. Provision of Rental Assistance

Where there is servicing rental assistance available, the State Director may agree to provide rental assistance to a project as part of a work-out agreement in order to enable tenants who could otherwise not afford the rents to move into a project and improve vacancy.

SECTION 5: MONITORING THE WORK-OUT AGREEMENT AND SUBSEQUENT SERVICING

10.26 MONITORING WORK-OUT AGREEMENTS

Once a work-out agreement has been developed and approved, the Loan Servicer must monitor the borrower's progress and provide guidance as needed. This is an important and necessary component of ensuring the success of the work-out agreement. The monitoring serves to make sure not only that the terms of the agreement are being upheld, but that they are having the desired effect of moving the project back into compliance. If not, the Loan Servicer must work with the borrower to amend the agreement to incorporate servicing techniques that will achieve the desired goals or cancel the work-out agreement and move to implement enforcement measures.

The Loan Servicer will conduct the monitoring in the following ways:

- Reviewing the financial reports submitted by the borrower. These include *Form RD 3560-7*, which must be submitted on a quarterly basis and bank statements, if appropriate;

- Holding semi-annual meetings at the project site with the borrower to track the progress of the work-out agreement; and

- Conducting supervisory visits to monitor progress with an agreement. Such visits are mandatory to determine if the work is being done when the work-out agreement includes correcting deferred maintenance or when reserve funds are being used for repairs. These supervisory visits should be held in conjunction with the quarterly meetings with the borrower.

10.27 SUBSEQUENT SERVICING AND IMPACT ON FUTURE LOANS

Any member of a borrower entity with a controlling interest in a property in which there are serious noncompliance issues and no work-out agreement is in place, or where the entity is in noncompliance with its work-out agreement, will not be eligible for further Agency loans. In a case such as this, the borrowers must make arrangements to restore compliance with Agency requirements and restore their financial viability.

In cases where the borrower and the Agency work together to make an acceptable work-out agreement, the borrower may be eligible to receive additional assistance after they have been in compliance with the work-out agreement for six consecutive months. In cases where work-out arrangements cannot be made, the primary basis for denying such assistance would be based on the borrowers' inability to meet eligibility requirements, shown by their track record of failing to meet existing requirements and responsibilities for other projects.

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SECTION 6: SPECIAL NOTE RENTS (SNR)

10.28 OVERVIEW OF SPECIAL NOTE RENTS *[7 CFR 3560.210]*

When a project is experiencing severe vacancies due to market conditions, the State Director may allow a borrower to charge a SNR rent to attract and keep tenants who have the financial ability to pay more than basic rent but who will not pay the current note rate rent. An SNR addresses the situation where some existing and prospective tenants are not willing to pay 30 percent of adjusted income or note rate rent because the rental rates would exceed those of other rental properties in the community. This action may only be taken after supervisory efforts by the Agency and management efforts by the borrower have not produced an acceptable level of occupancy.

10.29 SNR ELIGIBILITY REQUIREMENTS

A. Required Project Conditions

The borrower must document that the following conditions exist in the project for the Loan Servicer to consider allowing an SNR to be implemented:

- The project has been operational for at least 24 months (the borrower may request a waiver to this provision);
- No more than 10 percent of budgeted expenses are reflected as unrestricted cash on hand, and reserve account balances do not exceed the required accumulation-to-date minus authorized withdrawals;
- Over the most recent six-month period vacancy rates have averaged at least 15 percent or the project shows revenue losses of at least 15 percent;
- The loss of rents available is not a result of management's failure to effectively market the units; and
- Comparable rents in the area are lower than the previously approved note rate rents.

B. Borrower Requirements

To be eligible for the SNR, the borrower must:

- Be in compliance with Agency regulations and encourage occupancy through good maintenance and positive relations with tenants;
- Sign a statement agreeing to forgo return to owner for the duration of the SNR;
- Submit a budget with only the minimal sufficient operation and maintenance expenses;

- Have engaged in aggressive marketing efforts, including:

  ◊ Significant outreach efforts in the community, including, but not limited to, contacts listed in the AFHMP; or

  ◊ Obtaining approval from the Agency for a servicing work-out plan, exclusive of SNR features, at least three months earlier.

10.30 SUBMITTING AND PROCESSING SNR REQUESTS

In making the request for an SNR, the borrower submits the same information as they would when requesting a rent change. See Chapter 7of HB-2-3560 and *7 CFR 3560.203*.

The Loan Servicer reviews the documentation from the borrower and forwards the information with a recommendation to the State Director, who makes the final decision. If the decision is to approve the SNR, the following steps will be taken:

- Adjust the note rate column in the proposed changes to rent section of *Form RD 3560-7* to reflect rents needed for payment to the Agency amortized at an interest rate that is less than the full note rate on the borrower's *Form RD 3560-52*. The interest rate chosen may never be less than two percent.

- Set the interest rate of the SNR budget at a level that will make project SNR rates comparable with community rental rates.

- When an SNR is implemented in a Plan II Section 8/515 project, use lines 23 through 29 of *Form RD 3560-29* to report any additional payments to the reserve account required when HUD contract rents exceed SNR rates.

When the Approval Official determines a request for an SNR is not justified on the basis of the information submitted, the Approval Official will notify the borrower in writing of the reason(s) why the SNR is not approved. The borrowers will be advised of their appeal rights in accordance with 7 CFR Part 11.

10.31 CHANGES TO AND TERMINATION OF SNRS

Borrowers must request changes to SNRs at the time of budget review. If the local market conditions have not changed since the SNR was implemented, then no change is made to the SNR. If the conditions have changed, then the SNR is changed accordingly.

The borrower must notify tenants of the project in which the SNR is proposed to be changed just as would be done for tenants where a regular rent change request is made.

An increase in an SNR will be handled in accordance with regular program requirements for a rent change. See Chapter 7 of HB-2-3560.

An SNR is terminated when the note rate rent is regained.

10.32 RESTRICTION ON NEW UNITS

While an SNR is pending or in effect, the Field Office must not review or approve any other projects—of any type—in the same market area. State Directors may seek National Office approval for a waiver from this provision when an SNR has been in effect for 24 months.

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SECTION 7: ENFORCEMENT

10.33 MULTI-FAMILY HOUSING ENFORCEMENT TEAM

The Agency has established a Multi-Family Housing Enforcement Team to improve the Agency's efforts to detect and eradicate fraud, waste, and abuse in the Multi-Family Housing program. The mission of the Enforcement Team is to protect the interests of residents; ensure quality housing; restore public trust in Government investments; and eliminate program fraud, waste, and abuse. Within the scope of its mission, the Enforcement Team provides the following services:

- Performs problem property reviews including data reviews, site visits, interviews, reports on findings, recommendations for remedial actions, and follow-up actions to ensure problem resolution;
- Coordinates multi–state reviews of problem borrowers and management agents;
- Recommends enforcement actions to ensure borrower/agent compliance with regulatory and statutory program requirements;
- Analyzes problem property data collected by Field Office Staff and provides feedback concerning administrative actions for Field Office Staff to pursue in relation to problem properties;
- Coordinates enforcement efforts with the OIG, OGC, Department of Justice, Department of Housing and Urban Development, Federal Bureau of Investigation, and the Internal Revenue Service, as appropriate;
- Provides technical assistance and advice to Field Office Staff;
- Develops training materials and conduct training related to problem property analysis and enforcement techniques;
- Develops a standardized process to deal with problem properties and ensure comparable actions are applied in similar cases; and
- Guides field staff with appropriate actions to ensure resolutions of recommendations from OIG audits.

10.34 REQUESTING ENFORCEMENT TEAM SERVICES

Activities of the Enforcement Team may be initiated by the Deputy Administrator for Multi-Family Housing or by a request from a State Office.

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ATTACHMENT 10-A

HANDBOOK LETTER 301 (3560), SERVICING LETTER #1

ROUTINE NOTICE OF SERVICING RESULTS/CONCERNS

_____

Date

Dear _____:

We are writing to inform you of the results of a recent review of certain selected aspects of your operations. A copy of the results of our review is attached [Attach copy of supervisory visit report, physical inspection report, compliance review, reserve records, notice of payment due, etc.].

Please review the attached material and note the areas of concern listed. [We want to especially bring to your attention the following items:]

We are asking that you contact this office within 15 days of the date of this letter to inform us of the corrective actions you have taken, or plan to take, to correct the concerns listed. Our office address and telephone number are: [insert address and telephone number]

Sincerely,

_____

(Signature and title of Official)

Attachment

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ATTACHMENT 10-B

HANDBOOK LETTER 302 (3560), SERVICING LETTER #2

NOTIFICATION OF SERIOUS SERVICING CONCERNS

_____

Date

Dear _____:

We are writing to inform you that certain aspects of your project operations are of serious concern to the Agency.

A brief description of the items of concern which warrant attention is [provided below:]

[attached.]

We would like to arrange a meeting to discuss these concerns. [Please contact our office to confirm if you can make the tentatively scheduled meeting at the following time, date, and location:] OR [Please contact our office within 15 days of the date of this letter to make the necessary arrangements]. Our address and telephone number are (insert address and telephone number).

Please be prepared to discuss the matters of concern identified. [In particular, you may want to bring the following information to the meeting:]

We look forward to hearing from you.

Sincerely,

_____

(Signature and title of Official)

Attachment

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ATTACHMENT 10-C

HANDBOOK LETTER 303 (3560), SERVICING LETTER #3

NOTIFICATION OF INTENT TO PURSUE

MORE FORCEFUL SERVICING ACTIONS

Date

Dear _____:

We regret that earlier attempts to resolve [state the problems] have not been successful. We are writing to inform you that Rural Development intends to take further action unless alternative arrangements are promptly made with this office. If you have not contacted us within 15 days, we intend to pursue the [following actions:] [attached actions.]

[List actions, e.g., Forward a problem case report to the State Director, recommend an investigation by the Office of the Inspector General, demand a change in project management, place a recoverable cost charge on the account, forward a recommendation to the State Director to issue a Notice of Acceleration, etc.]

We are hopeful we can avoid the necessity of taking the steps outlined above. Unfortunately, we will be forced to do so unless we hear from you within 15 days from the date of this letter.

Please contact our office immediately if you wish to avoid the actions described above.

Sincerely,

_____

(Signature and title of official) [Attachment(s)]

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CHAPTER 11: LOAN RESTRUCTURING

11.1 INTRODUCTION

During the term of an Agency loan, borrowers may request Agency consent to restructure the loan for their project that will simplify the operation of the project or help address financial distress due to factors beyond the borrower's control. One example is when a borrower requests that loans be restructured to reduce administrative burden, improve cost-effectiveness and efficiency, or more effectively use the physical facilities common to projects. Another example is a project experiencing negative cash flow due to increases in local taxes and utilities that are rising faster than area rents. The methods used by the Agency to help accomplish the objectives stated above include loan agreement or loan resolution consolidation, loan consolidation, reamortization, and loan adjustments (writedowns).

This chapter describes the requirements for each of these loan restructuring techniques, and Agency procedures for reviewing, approving, and implementing such requests.

SECTION 1: ALLOWABLE TYPES OF RESTRUCTURING

11.2 OVERVIEW

As mentioned above, the loan restructuring activities that the Agency may approve include the following:

- **Loan agreement or loan resolution consolidation,** which is an administrative action whereby the loan agreements, or loan resolutions, for multiple projects held by the same borrower are consolidated and assigned a single new project number. The borrower still has separate loan notes and the Agency still tracks each loan individually, but all projects are administered by the Agency as if they were a single project;

- **Loan consolidation,** which is the consolidation of multiple loans for a single property into a single loan, with one note and one payment;

- **Reamortization,** which is a rescheduling of a borrower's debt;

- **Loan adjustments (writedowns),** which are reductions of the amount of the borrower's debt, allowing an otherwise sound project experiencing financial difficulties beyond its control to continue operating as a program property; and

This section addresses the regulatory requirements associated with each activity.

11.3 LOAN AGREEMENT OR LOAN RESOLUTION CONSOLIDATION REQUIREMENTS *[7 CFR 3560.410]*

The Agency may approve the consolidation of loan agreements or resolutions regardless of the total amount of debt being consolidated as long as the loan agreements being consolidated

represent loans made for the same purpose, to the same borrower, with the same plan of operation (e.g., nonprofit, limited profit, full profit). The terms and the due date of the loans involved must not be altered, and other security instruments must remain unchanged and must not be released.

Under no circumstances will loan agreements or loan resolutions be consolidated if the Agency's security position will be adversely affected. Any applicable restrictive-use provisions of the existing notes will continue to apply following consolidation.

11.4 LOAN CONSOLIDATION REQUIREMENTS *[7 CFR 3560.410]*

The Agency may approve loan consolidations under two circumstances:

- The loans are being transferred on new terms; or
- An initial and subsequent loan under one project number were closed on the same date at the same rates and terms.

The Agency may approve loan consolidations if, in addition to the above requirements, the following conditions are met:

- *Form RD 3560-52, Promissory Note* and the loan agreements or resolutions will be consolidated;
- Consolidation occurs on the Amortization Effective Date (AED) or as soon as possible after the AED is established;
- All project accounts being consolidated will be current after the consolidation process, unless otherwise authorized by the Administrator; and
- The Agency's security position will not be adversely affected.

11.5 REAMORTIZATION REQUIREMENTS *[7 CFR 3560.455 (b)]*

The Agency may approve the reamortization of any Agency multi-family housing loan account, although it will not reamortize accounts solely to remove a delinquency.

The Agency may reamortize accounts when doing so is in the best interest of the Government and when needed to improve the financial viability of the property and project operations. The Agency will not approve a loan reamortization if the reamortization will adversely affect the Government lien priority.

11.6 LOAN ADJUSTMENT (WRITEDOWN) REQUIREMENTS *[7 CFR 3560.455(c)]*

Borrower requests for loan writedowns must be part of an approved workout agreement with the Agency and be in the best interest of the Government. Writedowns are permitted with existing borrowers or transferees where:

- The causes are beyond the borrower's control—such as market weaknesses, unforeseen site problems, or natural disasters; and

- Sound management is evident or unsound management practices can be resolved by the removal of the responsible individuals in accordance with an approved work-out agreement with the Agency.

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SECTION 2: LOAN AGREEMENT OR LOAN RESOLUTION/LOAN CONSOLIDATION

11.7 OVERVIEW

Loan agreement or loan resolution consolidation offers several advantages. For instance, following loan agreement or loan resolution consolidation, all reporting, accounting, and project management requirements for the various projects being consolidated are fulfilled as a single project. In other words, borrowers need to maintain only one set of books and one operating budget, and can track all rents as a single project. In addition, because rental assistance agreements are not consolidated, borrowers can apply rental assistance across projects following consolidation. That is, waiting lists for the projects being consolidated will be combined and rental assistance can be assigned to eligible tenants in the newly formed "project" per assignment priorities.

Loan consolidation also offers several advantages. For instance, when consolidating a loan under new rates and terms in conjunction with a transfer, borrowers can combine notes and cost items. In addition, different portions of the property that may have been financed with separate loans can still be set up as distinct projects, but the borrower need track only one loan and one note.

State Directors or their designees may approve project or loan consolidations with the advice of the Office of General Counsel (OGC) and when all required conditions outlined in this chapter are met.

11.8 BORROWER SUBMISSIONS

A. Loan Agreement or Loan Resolution Consolidation

A borrower requests a loan agreement or loan resolution consolidation by submitting the following forms to the appropriate Field Office:

- *Form RD 3560-33A, Consolidated Loan Agreement;*
- *Form RD 3560-34A, Consolidated RRH Loan Agreement;*
- *Form RD 3560-35A, Consolidated Loan Resolution;*
- *Form RD 3560-7* as well as a project budget;
- Updated loan agreements/resolutions; and
- Management plans.

B. Loan Consolidation

For loan consolidations, borrowers must execute a new *Form RD 3560-9* for the new consolidated *Form RD 3560-52*, and submit it to the Field Office. The interest credit plan

originally established for the project applies to the consolidated note. If the interest credit plan is changed by submitting a new *Form RD 3560-9*, Loan Servicers will enter the new plan for the project through the field office terminal.

11.9 AGENCY PROCESSING OF BORROWER SUBMISSIONS

A. Loan Agreement or Loan Resolution Consolidation

1. Complete Form RD 3560-17A, Multi-Family Housing Consolidation of Projects/Loan Agreements/Resolutions

The Servicing Office completes *Form RD 3560-17A* to show all notes for the projects being consolidated.

2. Send Form to the State Office and St. Louis Office

The Field Office sends *Form RD 3560-17A* and a letter recommending the consolidation to the State Office for approval. The State Office then forwards the materials to the St. Louis Office for processing.

3. Obtain OGC Guidance

OGC guidance is required to accomplish loan agreement or loan resolution consolidations. Under no circumstances will the Agency consolidate projects if the security position of the Agency will be adversely affected. If required by OGC, all of the loan agreements or loan resolutions being consolidated may be secured by one deed of trust or mortgage describing all of the loans for the projects.

4. Maintain Loan Terms and Due Date

The Agency alters neither the terms nor the due date of the loan(s) involved. Other security instruments also remain unchanged, and are not released following the consolidation.

B. Loan Consolidation

Loan Servicers should note that there are some potential obstacles to consolidating certain loans. For instance, the St. Louis Office is unable to consolidate loans unless the loans are on the same plan of operation. In addition, direct loans cannot be consolidated with interest credit loans, and loans with HUD Section 8 subsidy cannot be consolidated with insured loans. In all other cases, however, the procedures outlined in this chapter will apply to loan consolidations.

1. Prepare Form RD 3560-52

Loan Servicers prepare *Form RD 3560-52* for the notes or assumption agreements being consolidated. If the Field Office does not have possession of the original note or assumption agreement, the Loan Servicer calls the St. Louis Office to request the return

of the original form so it is in the Field Office before the *Form RD 3560-52* is processed, or as soon as possible thereafter. *Form RD 3560-52* should be prepared on a monthly payment basis, as appropriate.

2. Prepare a Consolidated Loan Agreement or Resolution

Loan Servicers prepare a consolidated loan agreement or resolution using *Forms RD 3560-33A*, *3560-34A*, or *3560-35A*, as appropriate, to reflect current reporting requirements and the authorized initial investment attributable to the owner after the consolidation has occurred.

3. Obtain OGC Guidance

Consolidation of notes may only occur with OGC guidance. Under no circumstances will the Agency approve consolidation of *Form RD 3560-52* if the security position of the Agency will be adversely affected.

4. Complete Form RD 3560-17, Multi-Family Housing Note Consolidation, and Send a Copy to the Finance Office

Loan Servicers complete *Form RD 3560-17* to show all of the notes that are consolidated on *Form RD 3560-52*. Loan Servicers send a copy of *Form RD 3560-17* to the State Office for approval. The State Office forwards *Form RD 3560-17* to the St. Louis Office for processing.

5. Stamp Notes or Assumption Agreements "Consolidated"

The original and Field Office copies of all notes or assumption agreements that are consolidated will be stamped "consolidated" by Loan Servicers. The original instruments being consolidated will be stapled to the "consolidated" note and filed in the safe in the Field Office. When the consolidated note has been paid in full or otherwise satisfied, Loan Servicers will handle it and all other instruments according to RD Instruction 1951-A.

6. File New Security Instruments

Loan Servicers file new security instruments that describe the consolidated note to perfect the Agency lien position. If the new lien position taken is junior only to the previous lien position, the previous security instruments may be released with the guidance and assistance of OGC.

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SECTION 3: LOAN REAMORTIZATION

11.10 OVERVIEW

Reamortization is the process of revising an existing loan payment plan or schedule established for repayment of a loan. The new schedule is usually developed to enable the borrower to continue the objectives of the loan.

State Directors or their designees may approve the reamortization of Agency loans within their approval authority for the type of loan involved. Reamortization will not subject the borrower to any additional restrictive-use provisions beyond those associated with the original loan. For example, if there were 10 years of restrictive use remaining on a loan prior to a reamortization, there would still be 10 years remaining following the action. If the original loan contained no restrictive-use provisions, the reamortization would not add new use restrictions.

11.11 ACCEPTABLE USES OF REAMORTIZATIONS

A. Allowable Conditions for Reamortizations

The Agency may consider approving a reamortization if any of the following four conditions are met:

1. Preventive Measure for a Borrower Likely to Experience Delinquency

The State Director determines that the borrower and tenants cannot reasonably be expected to continue to meet their obligations unless the account is reamortized to reduce substantially the installments and rental rates.

2. Corrective Measure to Help Delinquent Borrower Attain Successful Operation

The borrower has a substantial delinquency that cannot be cured within one year. In addition, the borrower must have acted in good faith and maintained compliance with all applicable Agency policies and procedures.

3. Incentive to a Borrower Requesting Prepayment

The borrower has received an equity loan as an incentive to avert prepayment, or a subsequent loan has been made to a nonprofit corporation or public agency to purchase a project to avert prepayment.

4. Measure to Improve Project Operations

The borrower is not delinquent or likely to become delinquent, but proposes the reamortization to improve project operations. The State Director's approval is required for such reamortization requests.

B. Requirements for Obtaining a Reamortization

In addition, borrowers must demonstrate that the following criteria are satisfied before the Agency will approve a reamortization:

- The reamortization must be in the best interest of the Government;
- The reamortization will enable the borrower to operate successfully and carry out the purpose of the loan;
- The Agency's lien position remains unchanged; and
- The action is not proposed solely to remove a delinquency.

11.12 BORROWER SUBMISSIONS

To request a reamortization, the borrower must complete and submit *Form RD 3560-15, Reamortization Request* to the Field Office. Loan Servicers review the form and determine whether the required conditions for a reamortization exist.

11.13 AGENCY REVIEW AND APPROVAL

A. Field Office Actions

When the Field Office receives a request to reamortize, Loan Servicers will take several actions, as follows:

- Determine whether the conditions for a reamortization exist;
- Document the request in the official case file and on *Form RD 3560-15*; and
- Submit the request, the case file, and other pertinent information to the State Office for review.

B. Evaluating Borrower Requests

To receive Agency approval, Loan Servicers must review the borrower's submission and Agency records to ensure that the reamortization meets all of the following requirements, and adequately document in the case file and on *Form RD 3560-15* that the requirements are met. The analyses described below are used to evaluate all reamortization requests. Additional evaluation is required for requests involving projects with delinquencies or compliance violations (see Paragraph 11.14).

1. Budget is Adequate

The borrower's budget or plan of operations must provide reasonable assurance of the following:

- The newly scheduled payments will be made according to the terms of the proposed reamortization;

- The charges for the use of the facility or service are within the payment ability of those it is intended to serve and are comparable to similar units in the area; and

- Applicable rent increase procedures will be followed if any rent increase is required.

2. Management is Adequate

The borrower must demonstrate the following:

- The Board of Directors and memberships will obtain membership and community support, and will provide competent management for the continued operation of the borrower entity and the facility financed with the loan; and

- The borrower can provide acceptable management for the project and has corrected any management deficiencies identified by the Agency. Acceptable corrective actions may include revision of the management plan or employment of professional management services.

3. Security is Adequate

The borrower must demonstrate that the security will be adequate to protect the Agency's interests over the term of the reamortization.

C. Approval Recommendation and State Office Review

If the Loan Servicer determines that a borrower's request meets the requirements described in subparagraph B of this section, they must forward the case file with a recommendation for approval to the State Office for review. If the State Office concurs with the recommendation to reamortize, it will submit the request and any other pertinent information to OGC for legal advice and closing instructions, as needed.

When the indebtedness to be reamortized exceeds the State Director's approval authority but the State Director determines that the required conditions for approval can be met, the request for reamortization, the official case file, and all other pertinent information, along with complete comments and recommendations by both the State Office and Loan Servicers, is sent to the National Office.

D. National Office Exception

If the State Director concludes that the conditions for a reamortization cannot be met but a reamortization would be in the best interest of the Government, the file, along with recommendations from the Field Office, will be sent to the National Office for an exception. The State Director will submit all subsequent reamortization requests for the same project to the National Office for prior authorization.

E. OGC Guidance

When OGC determines that the reamortization request is legally sufficient, the servicing official will execute the reamortization request.

F. Agency Denial of Request

If the Agency denies a request for a reamortization, it must send a formal letter to the applicant indicating the reasons for the Agency's decision and informing the applicant of appeal rights. A copy of this letter should be placed in the case file.

11.14 ADDITIONAL EVALUATION FOR REQUESTS INVOLVING DELINQUENCIES OR COMPLIANCE VIOLATIONS

Reamortization requests to address a delinquency or compliance violations will be approved only as part of a work-out agreement acceptable to the Agency. Reamortization may be used to address reserve accounts that are not at the authorized levels, as long as the deficiency is not due to improper or unauthorized use of reserve funds.

To obtain a reamortization to address a delinquency or compliance violations, the borrower must correct or be able to effectively address the cause of the deficiency, demonstrate that the objectives of the loan can be met following the reamortization, and meet the requirements described below. To show that the objectives of the loan can be met, borrowers must demonstrate the following:

A. Project Feasibility

Borrowers must demonstrate that they are operating on a financially sound basis and have adequate operating income to:

- Repay the loan at the reamortized rate;
- Fund reserve accounts adequately;
- Fund tax and insurance accounts adequately;
- Pay operation and maintenance expenses as they become due; and
- Maintain an acceptable level of occupancy.

B. Property is Adequately Maintained

Borrowers must ensure that they provide modest, decent, safe, and sanitary housing by properly maintaining the property.

C. Housing Remains Affordable

Borrowers must provide affordable housing opportunities/services to eligible residents.

D. Compliance with Agency Regulations is Maintained

Borrowers must be in compliance with all applicable Agency regulations, including:

- Providing financial information to the Agency in a timely manner; and
- Maintaining required records needed to ensure the eligibility of residents (e.g., tenant certifications).

If the borrower cannot demonstrate the ability to meet the above-listed objectives, the Loan Servicer must reject the borrower's request for reamortization of the Agency loan and provide the borrower all applicable appeal rights.

11.15 PROCESSING REAMORTIZATIONS

In general, to reamortize an account, Loan Servicers must ensure that they obtain, complete, and sign all relevant forms, and obtain OGC review of documents for legal sufficiency, if needed. To actually process a reamortization, Loan Servicers must take the following steps, as applicable.

A. Complete Reamortization Agreement

Loan Servicers will complete *Form RD 3560-16* according to the FMI. The effective date and the due date for all payments will be the first of the month, except for labor housing loans, whose due date will be established in accordance with the FMI. *Note*: Appraisals will not be required in the case of reamortizations as long as there is adequate documentation that the Agency's security interest is protected.

B. Obtain *Form RD 3560-52* and Assumption Agreement

If the note or assumption agreement being reamortized is not held in the Field Office, the Loan Servicer will obtain the *Form RD 3560-52* and any assumption agreement from the St. Louis Office before processing the reamortization.

On the back of the original note or assumption agreement, below all signatures and endorsements, the Loan Servicer will insert the following: "A reamortization agreement dated _____, 20__, in the principal sum of $_____, has been given to modify the payment schedule of the note."

C. Establish End of the Reamortization Period

The reamortization period will end on the final due date of the note being reamortized, unless the term is extended with the advice and guidance of OGC and the

Agency's lien position is not altered. Any extension of the final due date should not exceed the lesser of the remaining useful life of the security property or the maximum term granted by the respective loan program authorizations.

The Agency may amortize the loan over a period not to exceed the remaining economic life of the project or 50 years, whichever is less. The Agency may extend the term of the loan to a period not to exceed 30 years or the remaining economic life of the project, whichever is less.

D. Establish Interest Rate

The interest rate for the account will remain unchanged except when the final due date has been extended. The interest rate charged by the Agency will be either the existing note rate, or the current rate at the time the reamortization request *Form RD 3560-15* is approved or closed, whichever is less.

E. Address Delinquent Reserve Accounts

The Agency may use reamortizations to address reserve accounts that are not at authorized levels, as long as the shortfall is not due to the borrower's improper or unauthorized use of reserve funds. Loan Servicers should take the following steps to address delinquent reserve accounts:

1. Modify the Loan Agreement or Resolution

The Loan Servicer should modify the loan agreement or resolution, or execute a new agreement or resolution, that bases the new fully funded amount (i.e., 10 percent of the indebtedness) and annual reserve requirement (i.e., one-tenth of the fully funded amount) on the amount of the reamortization, rather than on the original amount of indebtedness.

2. Establish Reserve Requirements

The Loan Servicer may establish reserve requirements at a higher level than the amount required for the reamortization to allow for capital expenditures that have been identified and quantified, as long as the budget will support a higher level.

3. Begin the Reserve Account with a New Base

Since the fully funded amount and annual requirement are reestablished based on the amount of the reamortization, the reserve account will begin with a new base. That is, any underfunded reserves existing prior to the reamortization will no longer be considered underfunded. In essence, the reamortization allows the borrower to begin with a "clean slate."

4. Allow the Borrower to Receive a Return on Investment

When a newly established fully funded amount and annual requirement are based on the reamortization amount, the Loan Servicer may allow the borrower to receive a return on investment if all other applicable conditions for receiving a return have been met.

F. Obtain OGC Guidance As Needed

Loan Servicers may obtain OGC guidance in the review of documents for legal sufficiency. OGC also may offer further guidance to properly perfect the reamortization.

G. Execute New Interest Credit Agreement

If the borrower is to receive interest credit benefits following the reamortization of the account, Loan Servicers will cancel the current interest credit agreement and prepare a new *Form RD 3560-9*.

H. Close the Reamortization

The Agency always closes reamortizations on the first day of the month. Unpaid interest to the date of closing may be capitalized.

I. Meet Other Procedural Requirements

In addition, Loan Servicers need to ensure that the following procedural requirements are met:

- All reamortized loans must be closed on Predetermined Amortization Schedule System (PASS). All initial and subsequent loans must convert to PASS in connection with the reamortization;

- When recoverable cost items are involved, they are first capitalized by adding them to the principal loan balance outstanding on the oldest loan and then the entire indebtedness (principal plus outstanding interest, overage, and late fees) is reamortized; and

- Audit receivables and late fees may be reamortized.

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SECTION 4: LOAN WRITEDOWNS

11.16 OVERVIEW

In cases of severe financial distress, the Agency may agree to a writedown of the debt, whereby the Agency agrees to reduce the outstanding loan amount. Writedowns should occur only when the value of the property is less than the outstanding Agency debt.

Generally, writedowns will occur simultaneously with a transfer and assumption for less than the total amount of outstanding debt. However, the Agency may write down debts and continue the account with the same borrower if doing so is in the best interest of the Agency, the property, and tenants.

In all cases, writedowns must be part of an approved work-out plan with the Agency, in the Government's best interest, and designed to correct circumstances beyond the borrower's control. Writedowns require approval by the State Director. The Agency should consider the project's suitability in accordance with Chapter 6 before approving a writedown.

Borrower equity in the project following the writedown will be no less than five percent of the amended loan balance for limited for-profit owners. The borrower may realize the eight percent return on investment on a maximum of five percent equity, if applicable. A reduced return may be authorized on amounts of equity contributed greater than five percent. Nonprofit and public agency borrowers may enter into workouts that propose loan-to-value ratios of 100 percent.

11.17 ALLOWABLE USES

Writedowns may only be approved when the conditions leading to a default were beyond the borrower's control and management is generally sound. Writedowns are used to address severe financial difficulties with a project and the Agency will consider all available servicing options before approving a writedown. Some examples of circumstances where a writedown might be an acceptable servicing solution include:

- Sustained market weaknesses in the property's community or region;
- Unforeseen site problems; or
- A natural disaster results in significant damage to the property.

11.18 BORROWER SUBMISSIONS

Borrowers requesting writedowns must submit the following documents to the Field Office:

- *Form RD 3560-15*; and

- A work-out plan, which includes:

  ◊ A revised budget; and

  ◊ A narrative description of project difficulties and proposed corrective actions.

11.19 AGENCY REVIEW AND APPROVAL

A. Appraisal

For a borrower to receive Agency approval for a writedown, the borrower is responsible for obtaining an "as-is" market value, subject to restricted rents. The Agency generally will not approve a writedown to an amount that is lower than the "as-is" unsubsidized value of the property. The Agency may require the general partner or primary person controlling the borrower to exit or waive equity, or both, to qualify for the writedown.

B. OGC Advice

OGC advice is required for all writedowns. The OGC review will primarily focus on the legal sufficiency of the transferee's organizational documents in cases where the writedown is occurring concurrently with a transfer.

C. Approval

As part of the writedown approval process, the State Office will review the following items:

- Field Office recommendation;
- Eligibility review; and
- An appraisal of the property.

The State Director is the approval official. The State Director may determine whether a writedown that does <u>not</u> include a change in the management structure of the project is acceptable.

11.20 PROCESSING WRITEDOWNS

To process a writedown, borrowers must execute documents per guidance from OGC.

CHAPTER 12: ACCOUNT LIQUIDATION *[7 CFR 3560.456]*

12.1 INTRODUCTION

This chapter covers Agency procedures regarding account acceleration, foreclosure, and liquidation for projects in default.

Loan Servicers should offer all appropriate special servicing tools to help borrowers with financial problems bring the account current. However, if it is clear that a borrower cannot continue with the loan, the Loan Servicer should analyze the feasibility of liquidation options and recommend the option that is in the Government's best interest, defined as the option that will result in the greatest net recovery.

Section 1 of this chapter describes how the Agency determines whether or not to liquidate, and if so, which of the available options would be least costly for the Government. This section provides a brief catalogue of liquidation options, a discussion of net recovery value and basic security loss, and an outline of how decisions to liquidate are ultimately made.

Section 2 of the chapter contains information on liquidation procedures for voluntary liquidation and foreclosure. A discussion about the acquisition of chattel property is also included. Section 3 discusses debt settlement.

SECTION 1: MAKING THE DECISION TO LIQUIDATE

12.2 AN OVERVIEW OF LIQUIDATION OPTIONS

When the Agency determines that liquidation is appropriate, it may accelerate the loan. The borrower must pay the full account balance and meet the other terms of the loan within the prescribed time frame, or the Agency may initiate foreclosure proceedings. Once the loan has been accelerated, the Agency will not accept partial payment unless required to do so by State law.

A. Voluntary Liquidation

1. Voluntary Sale

Sale of the security property is generally the most desirable option for both the Agency and a borrower who is unable to continue the loan. For the Agency, a sale to another party avoids the costs of foreclosure, as well as the costs related to owning and disposing of a property. For the borrower, it offers the best opportunity for being released from the debt without a major credit history blemish. A borrower may sell the property to a third party even after the account is accelerated.

If the borrower sells or transfers title of a security property on which the loan has been accelerated, the Agency requires payment in full to release any Agency liens or to

stop foreclosure action. However, to facilitate a sale after acceleration, the Agency may agree to release Agency liens in return for payment of the estimated net recovery value.

2. Deed in Lieu of Foreclosure

After the account has been accelerated, the borrower can offer to convey the security property to the Agency. The Agency will accept the deed in lieu of foreclosure only if the Agency will realize a greater net recovery value than would be obtained if foreclosure proceedings continued.

3. Assignment to Junior Lien Holder

The Agency may assign the note and mortgage to a junior lien holder, if such a lien holder makes an offer for the property in the amount of at least the net recovery value, and all appeal rights have expired.

B. Foreclosure

1. Agency Foreclosure

When all reasonable efforts have failed to encourage the borrower to voluntarily liquidate the loan through sale of the property, deed in lieu of foreclosure, or by entering into an accelerated repayment agreement, the Agency may initiate foreclosure proceedings.

2. Foreclosure by a Another Lien Holder

If there is a prior lien holder, the Agency must determine if the prior lien holder should have the opportunity to foreclose. Foreclosure by a prior lien holder may be a less costly alternative to Agency foreclosure. If the Agency intends to foreclose in cases in which there is a prior lien, the Agency must decide either to settle the lien or foreclose subject to the lien.

C. Acquisition of Chattel Property

The Agency will make determinations regarding disposition of chattel property that are in the best interest of the government. The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property.

12.3 NET RECOVERY VALUE

Estimated net recovery value represents the amount that the Agency could expect to recover from a property if it was liquidated after considering all costs associated with liquidating, holding, and selling the property. **Attachment 12-A** contains a net recovery value worksheet to aid in this calculation. Actual net recovery value is the amount the Agency does in fact recover from the sale of a property, after accounting for all costs.

The following sections provide guidance in estimating net recovery value.

A. Establishing Market Value

The market value of the property is the fundamental basis for establishing the estimated net recovery value. All calculations undertaken on the net recovery value worksheet provide additions or deductions from market value.

Depending upon the likely method of liquidation and at what point in the process the calculation is being made, market value may be based on an estimated value, on an appraisal or on the actual sale price. Early in the process of determining which liquidation method should be followed, the Loan Servicer may need to make a rough estimate of the market value based on any available information.

B. Environmental Considerations

The Loan Servicer's estimate of market value must take into consideration potential environmental hazards that may pose a liability issue for the Agency, and the presence of environmental resources for which the Agency will have an affirmative responsibility to take protective measures once it owns the property. Exhibit 12-1 provides a partial list of environmental factors for consideration.

To minimize Agency liability, the Agency must ensure, prior to acquiring property through foreclosure, that the property has been examined for potential contamination from hazardous substances, hazardous wastes, and petroleum products, including underground storage tanks. This should be accomplished by requesting that Field Office Staff complete the *ASTM Standard E-1528 Transaction Screen Questionnaire, (TSQ).* If the completed form raises any concerns it should be submitted to the State Environmental Coordinator for further evaluation and guidance.

The Agency also should examine the property prior to acquisition and consider any costs associated with environmental resources the Agency might be required to protect.

For additional information, see RD Instruction 1940-G.

Exhibit 12-1

Environmental Considerations

Environmental Factors

- Traffic or noise;
- Hazardous materials or waste;
- Radon, asbestos, or urea formaldehyde; and
- Lead-based paint or other lead contaminants.

Environmental Resources

- Aquifer recharge areas;
- Coastal barrier resources;
- Coastal zone management areas;
- Endangered/threatened species or critical habitat;
- Floodplains, wetlands, or flood hazard areas;
- Historical or archaeological sites;
- Important farmland, prime forestland, or prime rangeland;
- National landmarks;
- Wild and scenic rivers; and
- Wilderness areas.

C. Ordering an Appraisal

Guidance about ordering appraisals is presented in Chapter 4 of HB-1-3560. The point at which a formal appraisal is actually conducted will vary.

1. Valueless Lien

If the Loan Servicer's estimate suggests that the lien may be valueless, an appraisal should be obtained immediately. If the appraisal indicates that the lien is in fact valueless, it should be released without incurring servicing costs.

2. Deed in Lieu of Foreclosure

If, after acceleration, the borrower offers a deed in lieu of foreclosure, an appraisal should be obtained immediately so the Loan Servicer can determine whether it is in the government's interest to accept the deed.

3. Foreclosure

If the property will be going to foreclosure, no appraisal should be obtained until shortly before the sale is scheduled to take place. In areas where the foreclosure process can be lengthy, the value of the property could change before the sale if the appraisal is conducted too far in advance.

D. Holding Period

Nearly all costs and income used in the net recovery value calculation are affected by the holding period. For estimated net recovery value, the length of the holding period is estimated differently, depending on the likely method of disposition. The holding period should be estimated as the time between the date the net recovery worksheet is being filled out and the anticipated date for:

- Filing of the deed and the expiration of redemption rights (foreclosure);
- Filing the warranty deed (deed in lieu of foreclosure);
- Filing the release (release of valueless lien); or
- Payoff and release (debt settlement offer subsequent to acceleration).

The time for marketing and disposition, if the property is acquired, should also be considered when estimating the holding period.

E. Deductions from Market Value

Numerous costs associated with liquidation must be considered when determining the net recovery value, including the following costs.

- **Prior liens to be paid by the Agency**. In a case where a prior lien is involved, the amount required to repay the prior lien holder must be included in the calculation;
- **Junior liens to be paid by the Agency**. If the Agency pursues foreclosure, junior liens are not paid. However, in the case of a deed in lieu of foreclosure, it may be to the Agency's advantage to pay off a junior lien holder. The agency should conduct a title search to identify the position and the amount of each lien against the property;
- **Selling expenses to be paid by the Agency**. All transaction costs involved in selling the property, including advertising, commissions for selling agents, required seller certifications, surveys, points, and closing costs paid by the Agency, whether on behalf of the borrower in a voluntary liquidation, or as an Agency expense for a real estate owned (REO) sale;
- **Holding costs**. During the time that the Agency owns the property, the monthly interest accrued is multiplied by the number of months in the holding period;
- **Depreciation during the holding period**. The property may depreciate in value while it is being held by the Agency;
- **Administrative costs**. The administrative burden associated with holding a property includes the cost of liquidation, such as attorney fees, filing, recordation, advertising, and document service fees, that are customarily incurred in a foreclosure action; and

- **Management costs**. During the period the Agency holds the property it will accrue costs related to cleaning, securing, and maintaining the property such as utilities and real estate taxes.

F. Additions to Market Value

Although most of the adjustments to market value involve deductions to reduce the recovery amount, there are a few factors that can increase the market value.

- **Appreciation during the holding period**. In markets that are strong, the property may appreciate while it is being held by the Agency; and

- **Income during the holding period**. In general, the Agency does not lease properties. However, REO properties may be leased in limited circumstances, such as a property located in an area where keeping the property occupied could greatly reduce vandalism, or if there are tenants living in the property whom the Agency does not wish to displace.

12.4 BASIC SECURITY LOSS

The basic security loss is the difference between the property's market value and the outstanding Agency debt on the property, including principal, and other recoverable costs.

It is important for the Loan Servicer to consider the basic security loss in determining how to work with the borrower. For example, the debt settlement arrangements the Agency agrees to might be more lenient in the case of a borrower with a property that lost value through no fault of the borrower. This information can be used for portfolio analysis to help the Agency originate loans more effectively in the future.

12.5 ACCOUNT LIQUIDATION

A. Making the Decision to Liquidate

In all liquidation cases, the State Director will be responsible for the final decision to liquidate the borrower's account based on advice and counsel from the Office of General Counsel (OGC) and the following information supplied by the Loan Servicer:

- An opinion by the Loan Servicer about whether the borrower is forcing an acceleration to circumvent the prepayment process;

- The specific recommendations of the Loan Servicer on the method of carrying out the liquidation;

- The case file and any other pertinent information developed in support of the accusations;

- A summary of Agency efforts to work out an acceptable solution short of liquidation;

- A current appraisal of the security property will be completed by an Agency official authorized to make that particular type of appraisal and an estimate of the net amount that may be realized from the sale of the assets;

- The most recent balance sheet or financial statement from the borrower;

- A current statement of account from the St. Louis Office; and

- A problem case report.

- The Agency will handle liquidation, whether by voluntary liquidation or foreclosure, in accordance with the requirements at 7 CFR 3560.456(c) and (d).

In all liquidation cases, the State Director is responsible for the final decision to liquidate the account based on an opinion from OGC and relevant information supplied by the Field Office (e.g., case files, summary of efforts to work out an acceptable solution, appraisals of the property, borrower's financial statements and balance sheets, specific recommendations). If the Agency determines that the borrower has taken action to bring about the acceleration in an effort to avoid the prepayment process, the Agency will consider alternatives to acceleration, such as suing for specific performance under the loan and management documents.

B. Possible Outcomes of Agency's Decision to Liquidate

If the Agency decides to liquidate, there are several possible outcomes, which are as follows:

- The borrower may cure the default by developing and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a default;

- The borrower can voluntarily convey the property to the Agency;

- Transfer (sale or transfer and assumption of mortgage);

- Foreclosure;

- Payoff with use restriction; or

- Debt settlement (cash only) for minimum bid or greater.

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SECTION 2: LIQUIDATION PROCEDURES

12.6 OVERVIEW

After the Loan Servicer exercises special servicing options and the borrower is still unable to continue with the loan, the Loan Servicer must determine the feasibility of liquidating the borrower's account. Any recommendation should result in the greatest net recovery to the Government.

The borrower may liquidate voluntarily, either through sale of the property or deed in lieu of foreclosure. If it determined that the borrower's account must be liquidated, the Agency may recommend foreclosure and accelerate the loan.

12.7 VOLUNTARY CONVEYANCE

After acceleration, borrowers may voluntarily liquidate through deed in lieu of foreclosure or an offer by a junior lien holder. In the case of voluntary liquidation, the borrower is responsible for all expenses associated with liquidation and acquisition. The Agency will only consider acceptance of an offer of voluntary conveyance if it is likely to receive a recovery on its investment. The Agency will not accept a voluntary conveyance offer if it is not in the Government's best interest to do so. The Agency should refuse the voluntary conveyance if the Agency lien has neither present nor prospective value or recovery of the value would be unlikely or uneconomical.

Voluntary sale of the security property may be the least onerous option for the borrower and the least costly option for the Government. If there is an interested buyer, procedures for property transfer that should be followed are described in Chapter 7 of this handbook.

A. Payment of Liens

If the Agency accepts a deed in lieu of foreclosure, it will pay prior liens if the Government's investment and payment of the lien may be recovered. The Agency will accept conveyance subject to prior liens if the lien holder does not object. In this case, the Agency will make installment payments on the lien.

Junior liens must be paid by the borrower. If the borrower does not agree to pay these obligations, the Government will do so if it is in its best interest in the long run. The State Director determines whether the Agency will settle junior liens.

B. Required Components of an Offer of Voluntary Conveyance

An offer of voluntary conveyance will consist of the following documentation:

- *Form RD 3560-22, Offer to Convey Security*;
- Warranty Deed, which will be recorded only when the voluntary conveyance is accepted;

- A current financial statement, balance sheet, and information on present income and potential earning ability;

- For organization borrowers, a resolution by the Board of Directors that authorizes conveyance of the property; and

- Assignment of Housing Assistance Payments (HAP).

C. Appraisals

Prior to the Agency's acceptance of an offer of a deed in lieu of foreclosure, the current market value of the property must be obtained through an appraisal by a qualified appraiser.

D. Decisions

The Loan Servicer will submit the case file of the borrower to the State Office. The State Office will review the file and make a decision, after having obtained advice from the OGC. When the market value of the property is less than the Agency debt, the Agency must consider the borrower's current situation and future prospects for paying this debt.

Items to be included in the borrower's case file are shown in Exhibit 12-2.

Exhibit 12-2

Liquidation Option - Borrower's Case File

- Report on Multi-family Housing Problem Case;
- Liquidation and management plan;
- *Form RD 3560-22*;
- Resolution authorizing conveyance, if applicable;
- Current title search;
- Environmental review;
- *Form RD 3560-7;*
- *Form RD 3560-10;*
- Current appraisal prepared by a qualified appraiser;
- Due diligence report;
- Balance of Rural Development account and other liens, if any;
- Assignment of HAP contracts, if applicable;
- Current statement of account from the St. Louis Office;
- Development plan with breakdown of costs, if applicable; and
- *Form RD 402-2, Statement of Deposits and Withdrawals,* if applicable.

E. Closing of Conveyance

Closing of conveyance will be complete when the recorded deed has been returned to the Agency with no outstanding encumbrances other than Agency liens and/or previously approved prior liens. Costs incurred prior to the completion of the transaction will be charged to the borrower as recoverable costs.

Upon closing of the transaction, if applicable, the Loan Servicer will release liens and inform the borrower of the release from liability. Borrowers must be notified whether or not they have been released from liability.

The State Director will cancel any interest credit and suspend any rental assistance. Tenants must be informed of the possible consequences of liquidation. If the property will no longer participate in the Section 515, 514/516, or 521 programs, the tenants must be given a minimum of 180 days' written notice.

12.8 FORECLOSURE

State laws pertaining to acceleration and foreclosure will affect the procedures the Agency is required to follow. OGC should be consulted to ensure that appropriate procedures are followed.

A. Making the Acceleration Decision

The Agency must decide whether to accelerate the account and begin the foreclosure process. The decision to accelerate involves numerous considerations, many of which will vary case by case. The following issues should always be considered.

1. OGC Concurrence

Advice and counsel should be obtained from OGC before beginning the foreclosure process if:

- The foreclosure is based on a nonmonetary default; or
- The property also serves as security for a loan under another USDA program, such as the Farm Service Agency (FSA), since this may trigger liquidation of the other loan.

2. Tribal Land

If the security property is on tribal-allotted or trust land, the acceleration may be approved only after the Agency has offered, in writing, to transfer the account to an eligible tribal member, the tribe, and the Indian Housing Authority serving the tribe or tribes.

3. Role of Other Lien Holders

Depending upon the status of other liens on the security property, the Agency may invite other lien holders to join in the foreclosure action, or join in a foreclosure action initiated by another lien holder.

B. Acceleration

1. Acceleration Notice

If the Agency determines that the appropriate approach to liquidation is foreclosure, the process begins with an acceleration notice (*Guide Letter 1955-A-1, Notice of Acceleration to MFH Borrowers Liable for the Debt (Excludes Borrowers Who Were Discharged in Bankruptcy*) or *Guide Letter 1995-A-2, Notice of Acceleration to MFH Borrowers Discharged in Bankruptcy Who Have Not Reaffirmed the Debt*). The acceleration notice demands full payment of the account, including unpaid principal and interest, advances, and subsidy subject to recapture. It notifies the borrower of: (1) the reason for the acceleration, (2) the amount due, (3) the method of payment, (4) the opportunity for an informal discussion with the decisionmaker, (5) prepayment restrictions, and (6) the process for requesting an administrative appeal hearing. The notice gives the borrower 30 days to pay in full or request a hearing.

The acceleration notice must also include language regarding prepayment restrictions. If a borrower prepays an Agency loan made before December 21, 1979, the tenants must be given 180 days' notice that the project can be removed from the program. For information on these loans, see Chapter 15.

The notice must be sent to the borrower and any cosigners simultaneously by both regular mail and certified mail, return receipt requested. If the property address is different from the address of the borrower, the notice should be sent to the property address as well.

2. Payment Subsidy

If a borrower is receiving payment subsidy, the payment subsidy agreement will not be canceled when the debt is accelerated, but it will not be renewed unless the account is reinstated.

3. Offers to Pay

The decision to accelerate the account must not be made until the Loan Servicer has made all reasonable efforts to help the borrower become successful. Therefore, once the account has been accelerated, borrower efforts to cure the default will not be accepted unless required by state law. If state law requires that foreclosure actions be halted if an account is brought current, partial payment of the accelerated amount must be accepted. Otherwise, any payment for less than the full amount required to close the account should be returned to the borrower.

The borrower's account may be paid off by cash, transfer and assumption, sale of the property, or voluntary conveyance. The Agency may grant the borrower additional time to voluntarily liquidate. If an offer is deemed unacceptable, the Agency's denial is not appealable.

C. Review of the Acceleration Decision

Several remedies are available to borrowers who believe their accounts should not have been accelerated. These include an informal review, mediation or dispute resolution, and a formal appeal with the National Appeals Division of the Department of Agriculture (NAD). Foreclosure actions will be held in abeyance while an appeal is pending.

D. Transfers and Subsequent Loans During Foreclosure

Properties can be transferred during the foreclosure process. However, the foreclosure process should not be stopped until the applicant is determined eligible and the transfer is determined to be feasible and in the best interest of the government. For a discussion of how the value of a property is determined, see Chapter 7, Section 7.26.

E. Actions by the OGC

If the borrower does not cure the delinquency and no reasonable offers are made, the Agency must continue with foreclosure. The Field Office must forward the case file to the State Director. The State Director forwards the file to the OGC for review and advice.

F. Foreclosure Notice

A foreclosure notice that includes the following must be published:

- Projected sale date and location;
- Fair market value of the property;
- The amount to be bid by the Agency;
- The amount of Agency debt against the property; and
- Use restriction provisions.

Servicing Officials should take an aggressive approach to advertising foreclosure sales and marketing inventory properties. A list of potential buyers who would be interested in purchasing projects at foreclosure sale or as inventory properties should be developed. Notices of scheduled foreclosure sales can then be sent to interested parties in addition to advertising in newspapers and notifying local real estate agents.

G. Determining the Government's Bid at Foreclosure Sale

The Government's bid should equal the amount of the Agency's gross investment or the market value of the security, whichever is less. In states that require judicial foreclosure, the Government's bid should equal the judgment amount.

The State Director will designate an individual to bid at foreclosure, unless prohibited by State law. If the Agency is the senior lien holder, it can only submit one bid. If the Agency is not the senior lien holder, the designated bidder may make incremental bids in competition with other bidders.

Restrictive-use provisions may significantly affect the value of the project and its marketability. Properties can be appraised at actual market value based upon highest and best use of the property if the Administrator grants this authority on a case-by-case basis. The property can then be advertised and sold without restrictive-use provisions. This type of highest and best-use analysis is documented in the appraisal. Under these circumstances, the Government's bid will be the lesser of either the appraised market value based upon highest and best use, or the outstanding debt against the subject property.

H. After Foreclosure

1. Agency Reporting

After the property has been acquired, the Field Office must furnish the State Director with a report on the sale. Two forms must be filed: *Form RD 3560-19, Status of REO Property*, and, if applicable, *Form RD 3560-55*.

2. The Property

Upon acquisition, any existing leases must be transferred, and management agreements must either be extended or canceled.

3. The Borrower

If the property is acquired by the Agency, the Agency must credit the borrower's account with the Government's maximum bid. If the property is not acquired by the Agency, the borrower's account must be handled in accordance with State law.

The Agency must make attempts to collect any unsatisfied balances. When deficiency judgments are sought, the State Director must prepare *Form RD 1962-20, Notice of Judgment*, which establishes how the account is to be handled by the Field Office.

I. Property Valuation and Restrictive-Use Provisions

When a property is liquidated through foreclosure action or other debt settlement actions, the property may be released without restrictive-use provisions by requesting an exception from the Administrator. When such an exemption is granted, the appraiser will

be given instructions to value the property as conventional nonsubsidized property without restrictive-use provisions. The encumbering restrictive-use provisions in the loan documents will be nullified by the foreclosure sale or debt settlement unless ownership is continued by the current borrower, and that borrower is currently subject to restrictive-use as part of the original loan obligation or a subsequent servicing action.

12.9 ACQUISITION OF CHATTEL PROPERTY

The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property according to RD Instruction 1962-A, and applying the proceeds to the borrower's accounts. Authorized methods of acquisition of chattel property include:

- **Sales**, including execution sales, Agency foreclosure sales, sale by trustee in bankruptcy, public sale by prior lien holder, and public sale conducted under voluntary liquidation.

- **Voluntary conveyance**, which is acceptable only when the borrower can convey ownership free of other liens and the borrower can be released from liability under the conditions set forth in 7 CFR 3560.457. Payment of other lien holders' debts by the Agency in order to accept voluntary conveyance of chattels is not authorized. If the Agency declines an offer of voluntary conveyance of chattels, the Loan Servicer will provide a copy of the rejection to the borrower.

- **Attending sales**, which the Loan Servicer will attend unless it is deemed to be physically unsafe to do so or if attending the sale would cause unfavorable publicity. The Loan Servicer will attend a sale held by a prior lien holder if the market value of the chattel is significantly greater than the amount of the prior lien.

- **Appraising chattel property**, which is the Loan Servicer's responsibility prior to the sale. An outside contractor in accordance with RD Instruction 2024-A may conduct an appraisal.

- **Abandonment of security interest**, should the chattel property have no market value and obtaining title would not be in the best interest of the Government. Such a situation might occur if costs of moving or rehabilitation are excessive.

- **Bidding at sale**, which the Loan Servicer might do if there are no other bids or if the property may be sold at an amount which is less than the Government's authorized bid. The Loan Servicer may not bid if the chattel property under prior lien is significantly less than the amount owed to the prior lien holder or if the Agency debt has been satisfied. Loan Servicers may not bid at a sale held by a junior lien holder or at a private sale.

Unless costs are incurred after the government acquires title to the chattel property, the borrower will pay all costs related to acquisition of the property. The Loan Servicer will use *Form RD 3560-19, Status of REO Property,* to report acquisition of chattel property.

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SECTION 3: DEBT SETTLEMENT

Debt settlement is a process in which the Agency attempts to maximize repayment of outstanding debts that are not satisfied through voluntary or involuntary liquidation. There are four types of debt settlement: compromise, adjustment, charge-off, and cancellation. The Agency complies with the Debt Collection and Improvement Act of 1996 in pursuing outstanding debt. However, a majority of MFH loans are to non-recourse borrowers for which no additional recovery is possible after liquidation. Therefore, the Agency primarily uses debt settlement in conjunction with voluntary liquidation.

The State Director may approve or reject proposed debt settlements when the outstanding balance of the indebtedness amount in the offer is less than $1 million. The National Office must approve or reject any settlements totaling $1 million or more.

12.10 BORROWER ELIGIBILITY

A borrower may request debt settlement in conjunction with or after voluntary liquidation of security. The Agency may agree to settle a borrower's debt if:

- All liable parties apply for debt settlement;
- The loan security is sold for cash or transferred to a third party;
- The borrower pays a compromise or adjustment offer of the current market value of the security, less prior liens, plus any additional amount the Agency determines the borrower can pay; and
- The initial payment, with a compromise or adjustment offer must be equal to or greater than the value of the security, less prior liens.

The Agency will not debt settle a borrower's debt if:

- The borrower possesses another Agency loan for which he or she cannot or will not settle the debt;
- The Department of Justice has jurisdiction over the borrower's loans or has a case pending against the borrower because of a suspected criminal violation in connection with the debt or security for the debt; or
- The Agency requests the Department of Justice to institute a civil action against the borrower to protect its interests.

12.11 APPLICATION REQUIREMENTS

The Agency considers a borrower's financial status when evaluating the borrower's request for debt settlement. A borrower must submit complete and accurate information from which the Agency can make a full determination of the borrower's financial condition. This information must include the following items from all liable parties:

- A completed *Form RD 3560-57, Application for Settlement of Indebtedness*;
- A current financial statement and cash flow projections;
- Verification of income;
- Verification of assets for the past 12 months;
- Verification of debts greater than $1,000;
- Tax returns for the past three years; and
- Any other items requested by the Agency.

12.12 COMPROMISE AND ADJUSTMENT

A borrower is not required to dispose of security prior to application for debt settlement. However, if a borrower has disposed of security prior to applying for debt settlement, proceeds from the disposed security must first be applied to the borrower's account. If the Agency approves a compromise or adjustment offer, the Agency will cancel any debt remaining after the compromise or adjustment offer is paid and applied to the debt.

A. Secured Debts

Secured debts may be compromised or adjusted as follows:

- The debt is fully matured under the terms of the note or other instrument, or has been accelerated by the Agency prior to the settlement application;
- A compromise offer must at least equal the net recovery value of the security as determined by the Agency, less prior liens, plus any additional amount the Agency determines the borrower is able to pay based on a current financial statement; and
- An adjustment offer must meet the requirements of a compromise offer, except the payments may be made over the shortest period the Agency determines is feasible, not to exceed five years

B. Unsecured Debts

Unsecured debts are most frequently account balances remaining after the borrower has voluntarily liquidated security property. The borrower's compromise or adjustment offer must represent the maximum amount the Agency determines the borrower can pay based on a current financial statement and any other available information. An adjustment agreement may not exceed five years.

C. Handling Payments

All compromise or adjustment payments will be recorded. The St. Louis Office will hold payments in the Deposits Fund Account until notification is received from the State Office of the approval or rejection of the offer. For approved offers, payments will be applied in accordance with established policies, beginning with the oldest loan in the settlement. When the Agency accepts an adjustment offer, the St. Louis Office does not adjust the accounts involved until the borrower makes all the payments to the Agency.

D. Delinquent Adjustment Agreement

Adjustment payments that are more than 30 days past due are referred to the State Director. The State Director may:

- Void the agreement;
- Process a new debt settlement agreement; or
- Grant a time extension.

The borrower may appeal the cancellation of the adjustment agreement.

12.13 CHARGE-OFF

Charge-off is an administrative tool the Agency uses to write off nonperforming debt from the Agency's portfolio. However, borrowers remain liable for charged-off debt, and the Government may continue to pursue collection. The Agency may charge off nonjudgment debt when:

- The principal balance is $2,000 or less, and efforts to collect the debt have been unsuccessful or would not be economical;
- OGC advises in writing that the Agency's claim is legally without merit;
- Efforts to induce voluntary repayment are unsuccessful and OGC advises in writing that evidence to prove the Agency's claim in court cannot be produced;
- The borrower is unable to pay any part of the debt and has no apparent future debt repayment ability; or
- There is no security for the debt.

12.14 CANCELLATION

When the Agency administratively extinguishes a debt owed to it, a cancellation occurs. Under these circumstances, the Agency releases the borrower from liability for the debt.

A. Cancellation with Application

When the borrower applies for debt settlement, the Agency may approve the request if the borrower's application shows that the borrower cannot make any compromise or adjustment offer. The Loan Servicer must obtain documentation from the borrower that, due to unusual or extenuating circumstances, a compromise or adjustment offer is not feasible.

B. Cancellation without Application

The Loan Servicer may make a recommendation to cancel debt, without an application from the borrower in the following circumstances:

- All liable entities no longer exist;
- The 10-year statute of limitations of offset expires;
- The borrower has been discharged of the debt in bankruptcy;
- The debt, including a deficiency judgment, is otherwise legally without merit; or
- The account has been returned to the Agency after cross-servicing by the Department of Treasury.

C. Processing and Approving Cancellations

The Loan Servicer must execute the completed *Form RD 3560-57* and process the cancellation in accordance with the FMI.

The Loan Servicer must notify the borrower in writing of the debt settlement approval and the approximate amount that the Agency will report to the IRS. When the Agency cancels debt without application from the borrower, the Agency must send a letter regarding the debt cancellation to the borrower's last known address.

The Agency must cancel any requests for offsets against the borrower after debt settlement approval.

12.15 REFERRAL TO THE DEPARTMENT OF TREASURY

Because most borrowers are nonrecourse borrowers, the Agency does not often refer accounts to the Department of Treasury for cross-servicing or offset as there are no liable parties for the debt. However, there may be times when it is appropriate to refer an account to the Department of Treasury for debt collection. The Agency should refer an account to the Department of Treasury when:

- The debt is 180 days past due;
- The security has been liquidated; and

- The balance is due and payable.

The Agency should not refer an account to the Department of Treasury when:

- There are no liable entities to pursue;
- An internal offset is sufficient to collect the debt within three years after the debt becomes past due;
- The borrower is in compliance with an adjustment agreement;
- The debt is in litigation or bankruptcy action is pending; or
- The borrower is deceased.

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ATTACHMENT 12-A

NET RECOVERY VALUE WORKSHEET

I. BACKGROUND		
(1) Case Number:	(2) Borrower Name/ID:	
(3) Proposed Liquidation Option:		(4) Calculation Date:
(5) Estimated Holding Period: [1]		
II. CALCULATION OF NET RECOVERY VALUE		
(6) Market Value (use current appraisal)		
(7) Deductions from Market Value		
A. Liquidation costs		$_____
B. Acquisition cost		$_____
C. Settlement cost of prior liens		$_____
D. Estimated cost to operate during appraisal period[2]		$_____
E. Cost to correct health and safety violations		$_____
F. Cost to address environmental hazards (if different from E)		$_____
G. Selling costs		$_____
(8) Additions to Present Market Value		
A. Appreciation during holding period		$_____
B. Income during holding period		$_____
C. Total Additions (sum of items 8A and 8B)		$_____
(9) NET RECOVERY VALUE (6 minus Item 7G plus Item 8C)		

[1] The estimated inventory holding period prior to resale should be based upon previous experience in selling non-program property in the state and the availability of current funding for non-program inventory properties. If a state has not had experience in marketing non-program properties, the Multi-Family Housing Portfolio Management (MFHPM) Division in the National Office should be contacted.

[2] The cost to operate the project during the inventory holding period prior to resale should be based upon typical operating costs, excluding debt payments to the government, for similar projects in the servicing jurisdiction.

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CHAPTER 13: OTHER SPECIAL CASES
[7 CFR 3560.458 THROUGH 3560.459]

13.1 INTRODUCTION

There are a number of special circumstances that necessitate additional servicing procedures beyond those presented in previous chapters. Most of these cases involve characteristics unique to either a particular property or to a particular borrower. Property and borrower issues include a number of relatively uncommon, but nevertheless important, situations that Loan Servicers need to know how to address. Property issues include abandonment, valueless liens, and other security issues. Borrower issues include death, divorce, bankruptcy/insolvency, and membership liability agreements.

This chapter presents the requirements for these other special servicing cases and Agency procedures for addressing them.

SECTION 1: PROPERTY ISSUES

13.2 OVERVIEW OF PROPERTY ISSUES

The Agency's servicing goal is to protect the physical and financial asset that each project represents, and ensure that each project is operated in a way that meets program objectives. Sometimes, a property becomes troubled due to mismanagement, deferred maintenance, or market changes. As a result, the property may lose a significant share of its value. Whether a borrower chooses to abandon the property or to continue with its management, the Agency needs to address the situation created by the property's problems with appropriate servicing measures that protect the interest of the tenants and the Government. This section describes those measures.

In general, Loan Servicers should obtain the advice of the Office of General Counsel (OGC) as needed for handling the special circumstances addressed in this section. These circumstances include:

- Abandonment;
- Valueless liens;
- Other security issues; and
- Taking additional security to protect Agency interests.

Prior to any decision involving real property under the above-listed special circumstances, Loan Servicers will complete an environmental review under The National Environmental Policy Act (NEPA), and a due diligence report. Refer to RD Instruction 1940-G and Chapter 3, Section 3 of HB-1-3560 for further information.

13.3 ABANDONMENT

When the Agency believes that a borrower has abandoned a project, it will make an immediate check to determine if the borrower has moved and, if so, whether a forwarding address can be determined so that further servicing actions can be taken. The Agency will take the steps necessary to protect the Government's security interest in the property. In general, the steps taken following abandonment are similar to those taken following foreclosure, once abandonment has been confirmed.

A. Indicators of Abandonment

The Agency considers a property to be abandoned when any or all of the following conditions exist:

- The borrower cannot be located after the Loan Servicer has made diligent efforts to contact the borrower. This condition also applies to instances where the general partner(s) of a limited partnership cannot be located and the limited partners are unknown or cannot be located.

- The project remains unoccupied for an extended period of time, and the borrower makes no effort to maintain the security property, secure eligible occupants, and/or comply with the objectives of the loan within a reasonable period of time as specified by the Loan Servicer in a certified letter sent to the borrower requesting compliance.

B. Contacting Prior Lien Holders

If the property is not being maintained and the Loan Servicer determines that the borrower has abandoned the project, the Loan Servicer will attempt to contact any prior lien holders with a request that they take control of the property and make any emergency repairs necessary.

If no prior lien holder is involved or the prior lien holder cannot immediately be contacted or refuses to make the emergency repairs, the Loan Servicer will immediately notify the State Director and request permission to:

- Take possession of the property pending liquidation;

- Make health and safety repairs to prevent further deterioration of the security; and

- Enter into a management or caretaker's agreement on behalf of the owner.

C. Making Emergency Health and Safety Repairs

When making necessary health and safety repairs where an emergency exists, Loan Servicers should recognize that the repairs need to be completed as quickly and effectively as possible. Accordingly, a commonsense approach that balances the health and safety of tenants with the price, speed, and quality of the repairs should be employed. Bids for specific services may be obtained from several local contractors only if the bid

process does not adversely affect the health and safety of the tenants. Loan Servicers must document the circumstances leading to the emergency situation, as well as the reasonable steps taken to address health and safety concerns in the case file, to later back up any costs incurred.

All costs incurred at the project during the interim period between abandonment and eventual disposition by the Agency—including repair costs—are the responsibility of the borrower. The Agency treats the costs of managing abandoned property as a recoverable cost item.

D. Appointing a Caretaker or Management Agent

A caretaker or management agent will normally be appointed when the borrower has abandoned the security property or has failed to maintain its operation and the State Director determines, with the advice of OGC, that the Agency should take possession of the property to best protect the interest of the government. Selection of a caretaker or management agent is subject to the following requirements:

- **Qualifications.** Persons or firms chosen as caretakers or management agents should have experience in operating and managing similar properties or have business experience that qualifies them to provide the needed services. They must be located near the property to provide day-to-day supervision, or be able to appoint a qualified local person to meet this requirement. Caretakers will normally be selected for unoccupied projects or those not suitable for occupancy. Management agents will only be selected for projects that are occupied or suitable for occupancy. The selection process—which must comply with all applicable Federal Acquisition Regulation (FAR) requirements—must be adequately documented by Loan Servicers in the case file.

- **Allowable fees.** The amount of the management agent or caretaker fee must be set in accordance with Agency requirements for management fees. The requirements regarding management fees are established at 7 CFR 3560.102(i) and described in Chapter 3 of HB-2-3560. These fees will be paid as a project expense if project funds (e.g., reserve accounts) are available. If project funds are not available, fees will be paid with Government vouchers, considered a recoverable cost, and charged to the borrower's account. The fees will be paid on a monthly basis.

- **Rental rates.** Rental rates at abandoned properties will normally remain the same for eligible occupants as when the project was under the control of the borrower, although revisions may be allowed under certain circumstances with the approval of the State Director. Such conditions include:

  ◊ The lease agreement between the borrower and tenant permits changing the rates;

  ◊ A change of rates is needed to provide income sufficient to pay operational and maintenance expenses, including the caretaker's fee, and to repay the loan on schedule; or

◊ Any increase will not result in rental rates above the payment ability of eligible occupants, unless the State Director has given the authority to rent units to ineligible occupants.

- **OGC advice.** The State Director should consult OGC for advice, including the possibility of having a receiver appointed, when the following conditions exist:

  ◊ The project is occupied but rent is not paid or collected;

  ◊ The eligibility of the occupants cannot be determined; and

  ◊ The borrower has failed to comply with the objectives of the loan within a reasonable time frame as specified by the Loan Servicer in a certified letter to the borrower requesting compliance.

E. Addressing the Agency's Relationship with the Borrower

To resolve the abandonment situation, the Agency must determine the cause of the abandonment. If a property is abandoned in accordance with Section 13.3 A of this chapter, Loan Servicers need to document that the Agency will proceed with one of three servicing options: foreclosure, acceptance of a deed in lieu of foreclosure, or debt settlement. The Agency normally will proceed with foreclosure unless one of the other two options is offered by the borrower. If the Agency determines after investigating the causes for the abandonment that the borrower entity is no longer viable, it will normally proceed to foreclosure or accept a deed in lieu of foreclosure, if debt settlement cannot be achieved. The Agency will consider negotiated debt settlement only in cases where a default is evident and doing so is in the best interest of the Government. Properties in which debts are settled may be declared non-program properties.

Upon foreclosure, the Agency has the authority to seize any project accounts on which the Agency has countersigned (e.g., reserve accounts).

13.4 VALUELESS LIENS

A valueless lien exists at a property where the recoverable value of the lien is less than the estimated cost of recovery. When the Agency determines that it has a valueless lien, it will prepare a written determination to that effect and release its lien.

A. Declaring a Valueless Lien

To declare a valueless lien, the Loan Servicer must provide the following submissions to the State Office:

- Identification of property (legal description);

- Description of the Agency's lien position;

- Documentation of reasons that lien is determined to be without value; and

- Explanation of the reasons for releasing the lien and a description of the type of release sought (i.e., partial or full).

B. Documenting Valueless Liens

To document the reasons the lien on a project is determined to be valueless and to devise a strategy for releasing the lien, Loan Servicers should take the following steps:

- Within the context of a problem case report, write up an assessment of the value of the project and forward it to the State Director for review and guidance on how to release the lien; and

- Follow State Office instructions, as applicable.

13.5 OTHER SECURITY

The Agency also services other security instruments, such as collateral assignments, assignments of rents, Housing Assistance Payments (HAP) contracts, and notices of lien holder interest in a manner indicated by the agreements and according to acceptable practices in the respective states. When other security is taken, the Approval Official should develop a plan for servicing it at the outset.

- The State Director should develop any special servicing actions with the advice of OGC to protect the Agency's interest.

- Loan Servicers should file evidence of the other security in the loan docket in the Field Office.

- The Loan Servicer should make a notation on the management system card showing that the security has been retained.

13.6 OBTAINING ADDITIONAL SECURITY TO PROTECT AGENCY INTERESTS

The Agency generally does not need additional security to protect its interest. However, the Agency may negotiate with the borrower to obtain additional security in the form of real estate or other security when a decline in the value of the original security or other changes adversely affect the security available to the Agency in the event of a default. Examples of cases where the Agency may seek additional security include when the account is delinquent, the property has not been properly managed or maintained, or there is serious doubt that the borrower can carry out loan objectives.

While the Agency has the authority to seek additional security in the circumstances listed above, it is generally a negotiated, nonforcible action. However, there may be instances where the Agency can use its leverage to obtain additional security (e.g., a case where loan funds are used to purchase land on which the borrower plans to build a parking lot). In such cases, the Agency might demand an interest in the parking lot as additional security for the entire project. Additional security is taken by executing a deed of trust with the borrower.

A. State Director Authorization

In cases where taking additional security is warranted, the Loan Servicer must forward the borrower's case file to the State Director for authorization, along with a memorandum providing the following information:

- The facts that justify the taking of additional security;
- A conservative estimate of the market value of any real estate to be mortgaged (*Note:* It is not necessary to obtain an appraisal of the property to be mortgaged unless required by the State Director.);
- A brief description of any existing liens on the additional security, including the repayment terms and the unpaid balance;
- The name of the title holder and how the title to the property is held (*Note:* Title evidence is not required.);
- A plan for servicing the additional security to be taken; and
- A description of other servicing alternatives available to ensure that the objectives of the loan will be met and to protect the Government from loss.

The highest quality security available should be taken whenever additional security is considered. This means that if several security options are available, the option that has the least amount of risk associated with it (and would thus be easiest to liquidate if necessary) should be chosen. Security property with known environmental hazards or other risks generally should not be taken as additional security. Such risks will generally be identified when the Loan Servicer conducts due diligence, including an environmental review. When the Agency chooses not to acquire additional security property, whether in whole or in part due to the presence of or potential for release of hazardous substances or petroleum products, the Loan Servicer will notify the appropriate regulatory authority of the Agency's findings and actions.

B. OGC Advice

Loan Servicers should obtain OGC advice and assistance whenever additional security is taken. Specifically, OGC can provide a title opinion, which will advise Loan Servicers as to what lien position is available to the Agency.

13.7 SECURITY ISSUES INVOLVING PROJECTS WITH PARTICIPATION LOANS

The Agency's rule states that when other participation is involved, the Agency will service the account in accordance with appropriate Agency servicing regulations and the agreements made with the other participants at the time of loan origination.

SECTION 2: BORROWER ISSUES

13.8 OVERVIEW OF BORROWER ISSUES

Borrowers may occasionally experience special circumstances that affect their ability to operate the property and, thus, the Agency's approach to servicing their accounts. Bankruptcy, death, and divorce are events that require special attention to ensure that the interests of the tenants and the Government are protected. Similarly, special agreements that borrowers may have with members of the organization may affect the Agency's servicing approaches and decisions. This section addresses such special cases.

13.9 REQUIREMENTS FOR ADDRESSING BORROWER ISSUES

The Agency will address borrower accounts affected by special circumstances, such as death, bankruptcy, insolvency, and divorce, on a case-specific basis. The Agency will make servicing decisions in such cases that are in the best interest of the tenants and the Government. The Agency will bring legal action questioning the legal capacity of the borrower to administer the project if found necessary to protect the Government's interest. The borrower or the borrower's representative will provide to the Agency information concerning the:

- Evidence of legal action, due to a will or court actions that establish who is to become the owner, on the part of the heirs or trustee following the borrower's death;
- Financial status of the borrower;
- Status of the security property; and
- Impact of the identified actions on the project's operation.

In general, Loan Servicers should obtain the advice of OGC as necessary to handle circumstances involving death, bankruptcy, insolvency, and divorce.

A. Bankruptcy

The handling of bankruptcy cases varies from state to state. Therefore, the State Director may issue State Supplements providing more specific guidance to expedite the handling of those cases. In general, however, Loan Servicers should obtain and follow the advice of OGC as necessary whenever general partners file for bankruptcy.

B. Divorce

When individual borrowers with loans are involved in a divorce action, the Loan Servicer will review the case after the final divorce decree has been granted to determine if any action is needed for the future servicing of the account. The Loan Servicer will submit the case file to the State Director for advice if the Loan Servicer is uncertain of the servicing actions needed to protect the Agency's interest, or if continuation of the loan with the remaining borrower is not authorized. The Agency will not make subsequent loans to pay equity as a result of a divorce action.

C. Membership Liability Agreements

As a loan approval requirement, some borrowers may have special agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of a default. Alternatively, they may have instruments commonly referred to as individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan. In other cases, the borrower's note may be endorsed by individuals. The Agency will service these security and liability instruments in a manner indicated by the agreements to adequately protect the Agency's interest. The State Director will develop servicing actions with the advice of OGC.

CHAPTER 14: MANAGEMENT AND DISPOSAL OF REAL ESTATE OWNED PROPERTY

14.1 INTRODUCTION

When the Agency takes ownership of a project, adding the property to its inventory through liquidation proceedings, the project becomes real estate owned (REO). When the title transfers to the Agency, the property becomes an Agency asset. The Agency's objectives in managing and selling its inventory of REO properties include:

- Preserving affordable, decent, safe, and sanitary housing for tenants or potential tenants;
- Maintaining the value of the housing project;
- Protecting the Agency's financial interests;
- Ensuring that the properties comply with state and local code requirements and applicable environmental regulations; and
- Ensuring compliance with environmental requirements.

14.2 OVERVIEW OF THE CHAPTER

This chapter is divided into five sections.

- Section 1 describes the management of custodial and REO property. It describes acceptable management methods; discusses issues related to taking possession of custodial and REO properties, such as disposing of nonsecurity property and paying taxes and insurance premiums; and explains requirements related to maintenance, environmental concerns, and other management issues.
- Section 2 covers the disposition of REO property. It describes the methods for pricing and selling the properties and outlines procedures for accepting bids from potential purchasers. It also describes the standards the property must meet before being sold.
- Section 3 describes the environmental requirements that must be fulfilled before selling an REO property. These include requirements related to flood and mudslide hazard areas, wetlands, coastal barrier resources systems, historic places, protective covenants and easements, underground storage tanks, and hazardous substances.
- Section 4 outlines the procedures for processing and closing the sale of an REO property. These procedures are similar to the procedures for closing other Agency loans. This section also highlights some of the special considerations for REO properties.
- Section 5 provides instructions on processing credit sales for non-program terms.

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SECTION 1: MANAGEMENT OF CUSTODIAL AND REO PROPERTY

14.3 OVERVIEW

The Agency assumes management responsibility for two types of properties: custodial and REO. Custodial property is borrower-owned property that has been abandoned. REO is Agency-owned property to which the Agency has acquired title, either as a result of foreclosure or conveyance by deed in lieu of foreclosure. This section outlines the requirements for management of each type of property.

Loan Servicers are responsible for ensuring that custodial and REO properties are appropriately managed and maintained. The goal of property management is to protect the tenants and the interests of the Government. Consequently, Agency efforts to secure and manage these properties are to begin immediately once the following occurs:

- The property title is conveyed to the Agency; or
- The Agency determines property is abandoned.

14.4 MANAGEMENT METHODS AND CONTRACTS

The Agency has the authority to contract with qualified management entities to perform the management activities discussed in this section. The extent of management is dependent on factors such as:

- The nature of the project;
- The project's location;
- The condition of the project;
- Necessary maintenance; and
- Availability of acceptable management entities.

In some cases, the existing management agent can be maintained; in others, the Agency must hire a new management agent to provide all property management services on behalf of the Agency.

A. Selecting a Management Contractor

Management contractors are selected in accordance with Agency procurement procedures outlined in RD Instruction 2024-A. Alternative methods for selecting a management contractor may be established by the Agency if it is in the best interest of the Government. Alternative selection methods require advice from the Office of General Counsel (OGC). Prior to obtaining a management agent for custodial property, the Agency should determine if court approval is required.

B. Management Contract Requirements

At a minimum, management contracts must:

- Allow for properties to be added or removed from the contractor's assignment, whenever necessary, such as when a property is taken into custody, acquired, or sold during the period of a contract;

- Prohibit the contractor or associates of the contractor from performing repairs if the executed agreement calls for the contractor to provide detailed repair specifications;

- Require the management agent to hold security deposits in trust and handle them in accordance with the tenant's lease or occupancy agreement; and

- Include covenants requiring compliance with environmental laws.

The management agent must develop an Affirmative Fair Housing Marketing Plan (AFHMP), in accordance with RD Instruction 1901-E. The AFHMP must be submitted to the loan office. The AFHMP must receive written approval from the Civil Rights Coordinator in the Rural Development State Office. *Form RD 1955-62, Request for Contract Services for Custodial/Inventory Property or Program Services* is a sample statement of work for a project management contract.

C. Management Costs

The costs of management services related to REO property will be paid out of income generated by the housing project being managed. If income from the housing project is inadequate to pay for management services, Agency resources may be used to pay for management services.

D. Project Funds

When a property becomes REO, the Agency transmits operating and maintenance, reserve accounts, and escrow funds to the St. Louis Office. The former borrower's account is credited for these amounts. If there is a surplus of funds, the St. Louis Office will forward a refund check payable to the former borrower.

14.5 TAKING POSSESSION

A. Taking Custodial Possession

The Agency is authorized to take custody of security property when a borrower becomes incapacitated, dies, or has abandoned a security property. When the Field Office has attempted for more than 30 days and is unable to contact a borrower, the Loan Servicer must inspect the property to determine its status and attempt to locate and contact the borrower. The Field Office should seek the advice of OGC in making its determination and recommendation.

1. Determining Whether a Property Has Been Abandoned

The determination that a property has been abandoned requires significant investigation and documentation. In addition to the actions described in this paragraph, Field Office Staff must follow any procedures required by state or local law in order to confirm the determination of abandonment and to take custodial possession. The Agency cannot act to obtain possession of a property as long as a lien holder has legal possession of the property, or the borrower or the lien holder has a right to lease proceeds. Field Office Staff cannot classify a property as "abandoned" prior to documenting attempts to:

- Determine that there is no clear evidence of management presence at the project. For example, a site visit indicates that tenants are unable to contact borrower or property manager regarding repairs or rent collection, the project has fallen into disrepair due to a total lack of maintenance activities, or the Loan Servicer cannot locate the borrower or property manager;

- Locate the borrower through sources including, but not limited to, tenants, the postal service, utility companies, business associates, relatives, insurance agents, and tax authorities; and

- Determine whether there are other liens on the property**.** If liens exist, whether the lien holder(s) are willing to work with the Agency to secure the property.

2. Recommendation for Taking Custody

The Field Office will report its findings to the State Director. The report will recommend that a property be taken into custodial possession if it appears that the property has been completely abandoned and the Agency needs to assume responsibility for it to protect the security. Alternatively, if the Field Office reports that the property is occupied, the report will give details as to whether the occupants are under a lease or are unauthorized. The Field Office will provide any other relevant details and recommend future action. When appropriate, the State Director will authorize the Field Office to take custodial possession. When the Field Office believes that a property is abandoned, it must prepare a report that provides evidence of a property's abandonment. The report is placed in the borrower's case file, and a copy of the report is forwarded to the State Office.

3. Liquidation

The need to take custodial possession of a property may occur before or after a loan has been accelerated. If liquidation is not already in progress, taking custodial possession should initiate the process. Field Office Staff are responsible for conducting liquidation activities.

B. Acquiring an REO Property

When a Field Office acquires a property, Field Office Staff must notify the State Director. An additional REO case file should be created from the original case. The

REO case file should include the property title, recent inspection reports, appraisals, environmental reviews, and any other documentation related to the physical condition or value of the property. No information related to the borrower is needed in the REO file.

14.6 INSPECTING AND SECURING CUSTODIAL AND REO PROPERTY

Once REO property is acquired, Field Office Staff must inspect the property to determine what steps need to be taken to further ensure its security and maintain its value. The inspection will allow Field Office Staff to designate the property as program or non-program and evaluate the need for repairs.

A. Inspecting and Classifying the Property

Field Office Staff must perform an on-site field inspection of REO property to:

- Determine repair needs;
- Gather information to assist in completing the environmental review;
- Assist in updating the due diligence report and appraisal, as necessary; and
- Take necessary actions to secure and maintain the housing project.

Based on the results of the inspection, Field Office Staff designate REO property as program or non-program property after considering factors such as size; design; possible health and/or safety hazards; and obsolescence due to functional, economic, or locational conditions. REO property may be sold as non-program property it any of the following conditions exist:

- The housing project does not meet Agency requirements and the cost of bringing the housing into compliance is determined, by the Agency, to be economically unfeasible based on the amount of funds available to the Agency and the housing needs in the market area where the housing is located;
- Attempting to sell the property on program terms is not in the best interest of the Federal Government; or
- Hazardous substances or petroleum products have been released on the property and the cost of cleanup is estimated to exceed the dollar value the Agency will recover through sale of the property.

REO property in an area no longer designated rural is treated as if it were still in a rural area.

B. Securing Custodial and REO Property

When the Field Office assumes management responsibility and takes possession of REO or custodial property, immediate steps must be taken to inspect and secure the property whether by Field Office Staff or management contractor.

1. Physical Security of Vacant Properties

If the property is vacant, it should be locked or otherwise secured and a no trespassing notice should be posted. For REO only, after an inspection determines utility systems are in safe operable condition, utility companies should be contacted to maintain or reinstate utility service. An inventory should be made of any nonsecurity personal property left on the premises and efforts made to identify any owners or lien holders.

2. REO Properties Occupied by Tenants

REO property may be occupied by tenants with leases executed by the former borrower. The Agency may require tenants to sign a new lease, but if it is in the best interest of the Government, the Agency may honor existing leases. The Agency may evict unauthorized tenants.

When units in an REO property are under an existing lease and the Agency decides to continue the lease, the tenant must be notified, in writing, that the Agency has acquired the former owner's rights under the lease and that all payments should be remitted to the Agency's management agent. If a lease is to be terminated, the tenant must be notified, in writing, that their lease is being terminated in 30 days, and they must vacate. The OGC should be contacted for advice and assistance prior to evicting a tenant in order to obtain possession of an REO property.

Rent payments due and payable before the date the Agency acquired the property are applied to the borrower's account. Any surplus funds will remain with the project.

14.7 DISPOSITION OF NONSECURITY PROPERTY

The Agency has no legal claim to any nonsecurity, owner, or tenant property left on the premises. State or local law may affect procedures for disposing of personal property left on the premises of an REO or custodial property. Field Office Staff must comply with any state or local requirements, as well as the procedures discussed in this paragraph. If the owners or lien holders of any personal property that remains custodial or REO property can be identified and located, Field Office Staff must offer them a reasonable opportunity to remove the property. Any conversations with the owner of the property should be documented and placed in the case file.

A. Custodial Property

The Agency may remove any nonsecurity personal property from custodial properties as long as such property can be safely stored. Personal property cannot be removed and stored if:

- The storage facility presents a hazard to the security of the property, such as a leaking roof or unsecured area, which allows access to the property by unauthorized persons; and

- The personal property itself presents a hazard, such as flammables or explosives. Hazardous materials must be managed in compliance with Paragraph 14.10.

B. REO Property

1. Notice to Owners or Lien Holders of Personal Property

If the property is not retrieved after the initial notification, a certified letter should be sent, return receipt requested, notifying the owner or lien holder of the date on which the Agency will dispose of the property, and that the property may be retrieved before the disposition upon payment of any expenses incurred by the Agency related to the personal property, such as advertisement or storage.

2. Disposal of Unclaimed Property

The Field Office will dispose of unclaimed property in accordance with its value and conforming with local practices. For example, if there are items of significant value, an advertisement may be placed in the local newspaper. Unclaimed tenant property will be disposed of in accordance with the terms of the lease.

3. Income from Disposition

Proceeds from the sale of items under lien should be paid to any owner or lien holder after deducting Agency selling expenses. If there is no known owner or lien holder, proceeds are applied to the REO account.

14.8 TAXES AND INSURANCE

A. Taxes

REO property is subject to taxation by state and local political jurisdictions in the same manner and to the same extent as other properties, unless state law specifically exempts property owned by the Federal Government. If a jurisdiction changes the law to begin taxing Government-owned property, only taxes accrued after the effective date of the change will be paid. Field Office Staff must notify the taxing authority, in writing, when title to real estate is acquired and provide the Field Office address to which tax bills should be sent during Agency ownership.

If the value of the property is significantly less than the value at which it is being taxed, as soon as it is acquired the Agency may request a new assessment by the local taxing authority. Management contracts between the Agency and property managers may include provisions allowing the management agent to request a new tax assessment.

If property is acquired subject to a prior lien, before the Agency pays taxes, Field Office Staff must contact the prior lien holder to determine if that lien holder will pay the taxes.

Taxes on program property are paid when due. Taxes on non-program property may be deferred until the property is sold if the taxes that accrue before disposition exceed the value of the property. If the taxing authority schedules a tax sale before the Agency can sell the property, Field Office Staff will determine what is in best interest of the Government. To make this determination the Field Office Staff will calculate the net recovery value that would result from paying the taxes and continuing sales efforts. This calculation will be compared with the net recovery value if the Agency allowed the property to be sold for delinquent taxes. (See Chapter 12 for a more detailed discussion of net recovery value.)

B. Insurance

1. Custodial Property

Insurance on custodial property will be maintained per program instructions.

2. REO Property

Insurance will not be canceled when property is acquired. However, the Agency will pay additional premiums to continue coverage only when it is in the best interest of the Federal Government. If it is necessary to file a claim, Field Office Staff should submit the claim and direct that insurance proceeds be forwarded to the St. Louis Office.

14.9 ENVIRONMENTAL REQUIREMENTS

The Agency must complete the appropriate level of environmental review under the National Environmental Policy Act (NEPA) for proposed management activities involving custodial and REO properties in accordance with RD Instruction 1940-G. Activities subject to environmental review include repair and maintenance activities as well as leasing of custodial and REO property.

Repair and maintenance activities will normally qualify as categorical exclusions provided the proposed action will not alter the purpose, operation, location, or design of the project as originally approved. Leasing of custodial and REO property will normally qualify as a categorical exclusion provided the proposed action is not controversial for environmental reasons and will not result in a change in use of the property in the reasonably foreseeable future. If such criteria cannot be met, refer to RD Instruction 1940-G for further direction.

When certain environmental resources are present or when certain conditions exist, specific limitations or constraints are imposed by environmental law on the Agency's repair and maintenance activities and leasing activities. In such cases, an environmental assessment (EA) may be required to address the situation properly. Consultation with the State Environmental Coordinator is recommended before proceeding.

A. Repair and Maintenance Activities

1. Coastal Barrier Resources System (CBRS)

Any action proposed to be taken on a custodial or REO property within a CBRS must be coordinated with the State Environmental Coordinator and the Regional Director of the U.S. Fish and Wildlife Service (USFWS). In emergency situations to prevent imminent loss of life, imminent substantial damage to the inventory property, or the disruption of utility services, minimum steps necessary to prevent such loss or damage may be taken without first consulting the USFWS as long as the USFWS Regional Director is immediately notified of the emergency action taken.

Maintenance or repair is prohibited for property located within a CBRS if:

- The action goes beyond maintenance, replacement-in-kind, reconstruction, or repair and would result in the expansion of any roads, structures, or facilities;

- The action is inconsistent with the purposes of the Coastal Barrier Resources Act (CBRA); or

- The property to be repaired or maintained was initially the subject of a financial transaction that violated the CBRA.

The Administrator should be asked to review any cases where the Agency and the USFWS disagree on the effect of a plan of action or where otherwise prohibited maintenance and repair must be undertaken. Approval for action will not be granted unless the Administrator determines, through consultation with the Department of the Interior, that the proposed action does not violate the provisions of the CBRA.

2. Historic and Archaeological Resources

Properties that are listed or eligible for listing on the National Register of Historic Places, in whole or in part, will be repaired as necessary to protect their historic integrity after consultation with the State Historic Preservation Officer (SHPO) and the Advisory Council on Historic Preservation. If a property is listed or eligible for listing on the Register and also is located within a CBRS, the property cannot be repaired without the prior approval of the USFWS.

Field Office Staff will review the current Register to determine if the property is listed. If the property is not listed, the Field Office Staff will consult with the SHPO when the property is considered potentially eligible for the Register. A property is considered potentially eligible if it contains a structure more than 50 years of age or, regardless of age, if the property is known to be of historic or archaeological importance, or has apparent significant architectural features.

3. Floodplains and Wetlands

If the Agency is considering a substantial improvement or repair to custodial or REO property located in a floodplain or wetland, the Agency must first consider whether there are practicable alternatives to such further investment in the floodplain or wetland area. For example:

- Could the property be sold "as is" with notice of floodplain/wetland hazard?
- Could the property be sold "as is" with a requirement that the structure be removed from the site?
- Could the Agency remove the structure first and sell the land with notice of hazard?

If there are no practical alternatives to the substantial improvements, then the Agency may proceed with the improvements, provided they include any practical mitigation measures. On an existing structure, mitigation will generally involve some form of floodproofing, such as elevating hot water tanks or heating and ventilation units.

A substantial improvement is defined as any improvement the cost of which equals or exceeds 50 percent of the market value of the structure either (1) before the repair is started, or (2) if the structure has been damaged, before the damage occurred. The cost of compliance with health, sanitary, and safety codes is not included in the calculation of the substantial improvement cost, nor is the cost of repair to an historic structure included. If the repairs do not qualify as substantial, the Agency does not need to search for alternatives or mitigation measures.

4. Reportable Underground Storage Tanks

Properties that contain certain types of underground storage tanks must be reported to the state agency identified by the Environmental Protection Agency (EPA) within 30 days of Agency acquisition. **Attachment 14-A** provides a list of those underground storage tanks which must be reported, and those which are exempt from reporting requirements. A State Supplement will be provided on a case-by-case basis with the necessary EPA forms or acceptable state forms that may be used to accomplish the reporting, as well as detailing any additional state reporting requirements. A copy of the report must be maintained in the REO case file, and any prospective buyers of the property must be furnished with a copy of the report.

B. Lease or Management Contract

1. Historic and Archaeological Resources

A property that is listed or eligible for listing on the National Register of Historic Places may be leased or operated by management contract only after the Agency and the SHPO determine that the lease or contract will adequately ensure the property's condition and historic character.

2. Floodplains and Wetlands

Before executing a lease for a property containing wetlands or located in a special flood or mudslide hazard area identified by the Federal Insurance Administration, Field Office Staff must provide written notice of the hazard to the lessee. The notice must be attached to the lease. Any management contract must require the contractor to fulfill this obligation.

The lease or management contract for custodial or REO property containing wetlands or located in a floodplain area will also specify any uses of the property by the lessee or tenant that are restricted under any Federal, state or local floodplain and wetland regulations, as well as other appropriate restrictions. Examples of use restrictions would include prohibition of draining or filling of floodplain or wetland areas, and prohibitions of new aboveground construction on the portion of the property located in the floodplain or wetland area.

3. Environmental Requirements for Leasing

All property considered for lease must be evaluated for possible hazardous substance contamination. To do this, the Field Office Staff completes the *Transaction Screen Questionnaire* (TSQ), the initial level of inquiry in the due diligence process. (If a TSQ was completed prior to acquisition of the property, the Approval Official must determine if the TSQ should be updated.) If the completed or updated TSQ indicates potential contamination, it will be sent promptly to the State Environmental Coordinator for further evaluation and guidance. All cleanup actions, if appropriate, will be taken under the guidance of the State Environmental Coordinator.

When leasing REO property, in whole or part, Field Office Staff must, in all cases, notify potential lessees of the risk for potential contamination from hazardous substances, hazardous wastes, or petroleum products by providing the lessee with a copy of the Agency's due diligence report on the property. The due diligence report should be accompanied by a written disclaimer to the effect that the Agency does not provide any guarantee as to the accuracy of the report, but is simply making the results of its inquiry available to the interested public.

14.10 MANAGEMENT OF HAZARDOUS SUBSTANCES

The Agency will reasonably and prudently attempt to minimize its liability under hazardous substance and hazardous waste laws. Diligent efforts will be made to evaluate economic risks to real estate posed by the presence of contamination from hazardous substances, hazardous wastes, and petroleum products, including underground storage tanks. If a release or threatened release of hazardous substances, hazardous wastes, or petroleum products on abandoned, custodial, or Agency-owned property poses an imminent and substantial threat to human health and the environment, the Agency will notify the appropriate environmental regulatory authority and will take emergency response actions under the guidance of that authority.

The elements of potential liability and economic risk are addressed by the Agency by performing due diligence. Due diligence is the process of inquiring into the environmental condition of real estate in the context of a real estate transaction to determine the presence of contamination from hazardous substances, hazardous wastes, and petroleum products, and what impact such contamination may have on the market value of the property.

The Field Office Staff initiate due diligence by completing the *TSQ*, the initial level of inquiry in the due diligence process. If the completed TSQ indicates a potential for contamination, it will be sent promptly to the State Environmental Coordinator for further evaluation and guidance.

For all servicing actions that require a determination of market value, the appropriate level of due diligence will be performed in conjunction with the appraisal. Due diligence also must be performed in conjunction with any servicing action that may lead to acquisition of security property.

The Field Office Staff should be aware of suspicious situations during security inspections of custodial and REO property. If unauthorized dumping of potentially hazardous material is noted, due diligence will be performed.

To minimize the Agency's liability, any response action taken by the Agency in responding to a release or threatened release of hazardous substances or petroleum products on inventory property will be taken in consultation with and at the recommendation of the appropriate environmental regulatory authority. In the case of custodial property, the State Environmental Coordinator may initiate, as necessary, limited emergency response actions to stabilize an emergency or imminent and substantial threat to human health and the environment.

If the Agency is notified or made aware of the presence of an underground storage tank on custodial or REO property, Field Office Staff must ensure that the tank complies with appropriate environmental regulatory authority requirements or is removed. When reinstalling a fuel storage system, aboveground storage tanks should be used where feasible.

Field Office Staff must complete or update a TSQ to document the existing environmental conditions at the property prior to leasing inventory property.

14.11 PHYSICAL MAINTENANCE AND REPAIR

Custodial property will be maintained and repaired only as needed to protect the security of the property and to prevent deterioration. In the event of damage or theft, the procedures described under subparagraph A of this section should be followed.

REO property designated to be sold as program property must be repaired, as necessary to meet the Agency's requirements for decent, safe, and sanitary housing.

REO property designated to be sold as non-program property will be managed in a manner that:

- Removes health and safety hazards;

- Prevents deterioration; and

- Complies with state and local requirements for the sale of the property.

Additional repairs or renovations will only be made if they will enhance the sale value of the property and are determined, by the Agency, to be in the best interest of the Government.

A. Vandalism and Theft

Field Office Staff will report any willful damage or theft to the local law enforcement authorities and in whatever manner necessary, to attempt to resolve the incident, including signing complaints and testifying at hearings or trials.

Field Office Staff should send a written report of the incident to the State Director and a copy to the Regional Office of the Inspector General (OIG). The State Director, in consultation with the OGC as necessary, will advise and assist the Field Office Staff.

Damage to REO program property as a result of vandalism and theft may be repaired as necessary to continue marketing. Repairs may include cost-effective improvements to minimize the likelihood of future damage, such as increased lighting, security fencing, and removal of shrubs that limit visibility. Non-program property should be broom swept, but generally will not be repaired unless necessary to prevent deterioration. Custodial property should be repaired only to protect the security and prevent deterioration.

B. Off-Site Repairs or Improvements

The Agency may require off-site repairs or improvements to protect property from damage, to protect the Government's interest or enhance the marketability of property. Off-site improvements must be approved by the State Office. To obtain approval, Field Office Staff must prepare a justification that demonstrates failure to make the improvements would likely result in a loss in property net recovery value greater than the expenditure, and that there are no other feasible means with state or local entities to accomplish the same result.

To obtain off-site improvements, the Agency may enter into a contract with a private company or enter into a cooperative agreement with a state or local government, or other entity to obtain repairs or improvements. Under a cooperative agreement, the entity will provide money, property, services, or other items of value to the entity to accomplish a public purpose. While cooperative agreements are not a contract action, the authority, responsibility, and administration of a cooperative agreement must be consistent with contract action. OGC should be consulted when a cooperative agreement is considered.

C. Lead-Based Paint

The property must be managed in a manner consistent with RD Instruction 1940-G.

1. Control of Lead-Based Paint Hazards

To control lead-based paint hazards, the Agency must ensure that painted surfaces in the property are intact. Surfaces that are not intact must be repaired in a lead-safe manner.

2. Disclosure

The Residential Lead-Based Paint Hazard Reduction Act of 1992 requires lessors of housing built before 1978 who receive Federal assistance to provide the lessees with information about the housing's lead history and general information on lead exposure prevention. Under the disclosure rules, before the lessee becomes obligated under any contract to lease the housing, Field Office Staff must:

- Provide the lessee with the lead hazard information pamphlet, *Protect Your Family from Lead in Your Home*, available from the National Lead Information Clearinghouse at 1-800-424-LEAD, or a similar EPA-approved pamphlet developed by the state; and

- Disclose the presence of known lead-based paint and/or lead-based hazards in such housing and provide the lessee with any lead hazard evaluation report available to the Agency.

14.12 SPECIAL USES OF REO

A. Transitional Housing for the Homeless

By a Memorandum of Understanding (MOU) between the Agency and the Department of Health and Human Services, REO property that is not under lease or sales agreement may be leased to public bodies and nonprofit organizations to provide transitional housing for the homeless.

B. Mineral Leases

When it is in the best interest of the Government, the Agency may lease mineral rights associated with REO property. OGC should be contacted for assistance in preparing the lease agreement. The appropriate level of environmental review must be completed prior to any agreement to lease mineral rights. Since such actions may be controversial and may have the potential for significant impact on the environment, prior consultation with the State Environmental Coordinator is required.

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SECTION 2: DISPOSITION OF REO PROPERTY *[7 CFR 3560.503]*

14.13 OVERVIEW

The Agency will make every effort to sell REO properties quickly and at the best possible price. Whenever possible, preference will be given to selling REO program property to a program borrower. Preference will be given to offers from bidders who are determined eligible by the Agency to purchase REO property designated to be sold as program property.

A. Sale Methods and Pricing

Most REO properties are sold through public drawing. However, the Agency may sell properties through auction, sealed bid, negotiation, or agreements with other Federal Agencies, such as the Department of Housing and Urban Development (HUD).

REO properties are initially priced for sale at their present market value, as determined by appraisal. Administrative price reductions may be taken over time to facilitate sale of the property (see Paragraph 14.14 for a discussion of price reduction). A schedule is published that restricts sales of program property to program-eligible buyers for a period of time before any offering to the general public, and whenever there is a reduction in price.

An Affirmative Fair Housing Marketing Plan, as described in Paragraph 14.15, must be prepared for REO multi-family housing properties of four or more units.

B. Financing

When funds are available, the Agency may offer financing to buyers of REO property. When program credit is offered, the loan is processed following the procedures described in HB-1-3560.

Non-program credit terms are offered when the buyer is not eligible for a Section 514 or 515 loan, or the property does not qualify as a program property. Section 5 provides instructions for credit sales on non-program terms. Buyers who receive financing on non-program terms must be advised that they are not eligible for interest credit or rental assistance.

C. Warranty

The Agency does not provide a warranty of either the title or the physical condition of any REO property.

14.14 PRICING AND SALES SCHEDULES

REO housing is priced and initially offered for sale at its present market value, based on a current appraisal. Administrative price reductions may reduce the offering price to facilitate the sale. Mineral, water, and similar rights are generally sold with the property and are not sold

separately except when the Government's security interest will not be jeopardized. Lease or royalty interests that do not pass by deed are assigned to the buyer.

A. Appraisals

To determine the property's present market value, the Field Office must arrange for an appraisal in accordance with the procedures described in Chapter 4, Notice of Funding Availability (NOFA) and Initial Application Process. If repair or improvement is planned, the appraisal must provide both as-is and as-improved values. Each as-improved appraisal must include a list of the planned repairs. Any special flood or mudslide hazard areas or wetlands and related use restrictions must be reflected in the appraisal. All REO property considered for disposal or lease must be evaluated for possible contamination from hazardous substances or petroleum products through the process of due diligence and completion of the *TSQ* as described in Paragraph 14.29. This will normally be completed at the same time as the appraisal.

A property must be reappraised whenever its condition has deteriorated, it has been significantly damaged or vandalized, additional repairs and improvements have been made, or there has been a change in market conditions. Field Office Staff should be especially alert to potential contamination from unauthorized dumping while the property is owned by the Agency and, if necessary, update the TSQ and the appraisal prior to sale or lease. The need for reappraisal should be established as quickly as possible so that the property is offered at its true value. Appraised value is not affected by administrative price reductions.

B. Sales Schedules and Administrative Price Reductions

The sale of REO program property is restricted to program-eligible buyers when a property is offered for sale and any time an administrative price reduction is taken. Exhibit 14-1 provides the sales schedule for program property. The sales price is fixed when a sales contract is executed and does not decrease further based upon scheduled price reductions.

Exhibit 14-1 Sales Schedule for Multi-family Housing REO Property Program Property	
Days from Initial Offer	**Action**
Day 1	Initial offer (appraised as-is value with subsidy).
Day 45	If no acceptable offer, reduce price by 10 percent and offer again.
Day 91	If no acceptable offer, reduce price by another 10 percent or use other methods (additional 10 percent price reductions allowable after 45 days)
Day 180	If no acceptable offer, submit REO case file with documentation of marketing efforts to State Office for further advice on sales incentives or to authorize sealed bid/auction. Loan Servicer may reevaluate whether the project should be classified as a program property.

Exhibit 14-2 provides the sales schedule for non-program properties. If a program property has not sold following active marketing efforts and two price reductions, Field Office Staff will reevaluate the property to determination if it should continue to be marketed as a program property. The reevaluation process may include an updated appraisal.

Exhibit 14-2 Sales Schedule for Non-Program REO Property	
Days from Initial Offer	**Action**
Day 1	Initial offer (appraised as-is value without subsidy).
Day 45	If no offer, reduce price by 10 percent and offer again. Additional 10 percent price reductions are allowable after 45 days.
Day 91	If no acceptable offer, reduce the price by another 10 percent or use other sale methods.
Day 180	Submit REO case file with documentation of marketing efforts to State Office for further advice on sales initiatives to authorize sealed bid/auction.

14.15 MARKETING AND ADVERTISEMENT

A good marketing plan is the key to reaching the maximum number of potential buyers and to ensuring that eligible program applicants have an opportunity to purchase REO properties. The Agency may advertise directly or contract for advertising services. Broker contracts may include advertising services. All advertisements must state occupancy or environmental restrictions.

A. Fair Housing and Affirmative Fair Housing Marketing Plan

All advertising must meet equal housing opportunity requirements and contain the equal housing opportunity statement and logo.

B. Truth in Lending Requirements

If the availability of Agency financing will be advertised, marketing efforts must conform to the requirements of the Truth in Lending Act. Exhibit 14-3 highlights these requirements, see RD Instruction 1940-I for additional information.

Exhibit 14-3

Truth in Lending Highlights

- Advertisements that state specific credit terms must state only terms that will actually be offered.
- Any finance charge listed must be stated as an annual percentage rate.
- Key terms related to financing used in the advertisement must be defined

C. Advertising and Marketing Methods

Advertising efforts should be designed to reach a broad audience. Each Field Office should identify appropriate marketing efforts and tailor them for each market area. At a minimum, advertisements must be placed in newspapers of general circulation and posted on the Field Office bulletin board. Other marketing efforts that may be appropriate include:

- Posting an advertisement on the Agency's multi-family housing REO Web site at https://mfhreo.sc.egov.usda.gov. This site allows staff to upload, modify, and delete properties. The general public will view multi-family housing REO properties for sale at: http://www.resales.usda.gov;

- Posting advertisements in public locations accessible to prospective purchasers, including community bulletin boards and major employment sites;

- Broadcasting announcements on radio or television; or

- Informing potential program applicants or investors of the availability of REO properties.

Advertisements must include the following:

- Appropriate language, stressing the need for potential buyers to complete and submit an application and other required documentation;

- Any restrictive-use requirements that will be attached to the project and added to the property's title;

- Sale price; and

- Date, time, and location of drawing. The date and time must allow adequate time for advertising and review of application packages.

D. Review of Marketing for Unsold Properties

At least quarterly, the State Director must review the status of unsold REO property to ensure that acquired properties are being placed on the market promptly, properties on the market are selling within a reasonable time frame, and that properties under contract are closed in a timely manner. Of particular concern are:

- Properties acquired more than 90 days ago that have not yet been made available for sale;

- Program properties that have been available for sale for 6 months or more and are not under contract;

- Non-program properties that have been available for sale for 4 months or more and are not under contract; and

- Properties that have been under contract for more than 60 days and have not closed.

14.16 SPECIAL MARKETING TECHNIQUES

A. Buyer Incentives

The State Director may authorize buyer incentives when Field Office Staff provide evidence that a specific market area is depressed and the incentives are required to stimulate buyer interest. To request approval for buyer incentives, the Field Office must describe past efforts to sell the property and explain why the proposed incentives are expected to produce improved results. Incentives, such as the payment of closing costs, may be appropriate for any property. Amortization schedules longer than the standard term may be offered for non-program properties.

B. Broker Incentives

When an additional broker incentive is needed, such as when a very low-value property offers an inadequate commission, the State Director may authorize a minimum commission or fixed-amount sale bonus. To request the incentive, the Field Office must describe the past efforts to sell the property and justify the amount and the purpose of the incentive. Upon the approval of the State Director, a written offer of the incentive that specifies the requirements and circumstances in which the incentive will be given must be provided to the broker.

C. Acquisition of Land, Easements, or Rights-of-Way to Effect Sale

When it will help the sale of REO property and it is in the best interest of the Government, the State Director may authorize the acquisition of adjacent land, easements, or rights-of-way in order to cure title defects or encroachments. Additional land may not be acquired at a cost in excess of its appraised market value.

14.17 REO PROPERTY NOT MEETING PHYSICAL STANDARDS

When REO property does not meet the Agency's dwelling standards, and making repairs that will allow the property to meet these standards is not economically feasible for the Government, the property is listed, advertised, and sold with specific occupancy restrictions.

Housing that does not meet the Agency's dwelling standards may still be considered decent, safe, and sanitary if it:

- Is structurally sound and habitable;
- Has a potable water supply;
- Has functionally adequate, safe, and operable heating, plumbing, electrical, and sewage disposal systems;
- Meets the Agency's thermal performance standards; and
- Is safe—that is, a hazard does not exist that would endanger the health or safety of occupants.

The deed by which such a property is conveyed will contain a covenant restricting the new owner from allowing occupancy of affected residential units until it those units meet the Agency's dwelling standards, as discussed in Chapter 3 of HB-1-3560. Property that is not decent, safe, and sanitary must still meet the Agency's environmental requirements, including the management of hazardous substance requirements discussed in Paragraph 14.10.

In the event that the Agency has acquired property that is unsafe and cannot feasibly be made safe, for reasons that are environmental in nature or relate to contamination from hazardous substances or petroleum products, Field Office Staff will provide appropriate information to the State Director, including the observations and recommendations of the State Environmental Coordinator. The State Director will submit the case file, along with complete documentation of the problem and a recommended course of action, to the Deputy Administrator, Multi-Family Housing, with a copy to the Director, Program Support Staff, for their joint review and guidance.

A. Notice of Occupancy Restriction

The notice of sale and sale contract must describe the specific conditions that prohibit occupancy and the items necessary for the property to meet decent, safe, and sanitary standards, using language similar to the following:

> "Pursuant to Section 510(e) of the Housing Act of 1949, as amended, 42 U.S.C. 1480, RHS has determined dwelling unit or units on this property inadequate for residential occupancy. The quitclaim deed by which this property will be conveyed will contain a covenant excluding the inadequate residential unit(s) from residential use until the dwelling unit(s) is repaired or renovated as follows:" (insert the items necessary for the property to meet decent, safe, and sanitary standards, clearly indicating the inadequate unit(s) and necessary repairs for each unit)

For purposes of advertising, the list of specifications may be replaced with a statement to contact the Agency, or the real estate broker under an exclusive listing contract or "any real estate broker" for open listing agreements, whichever is relevant, for a list of specific items necessary for the property to meet decent, safe, and sanitary standards.

B. Quitclaim Deed Restrictive Covenant

The quitclaim deed must contain a covenant restricting residential occupancy if units within the project fail to meet the Agency's dwelling standards. The covenant must describe the conditions that prohibit occupancy of specific units and specify the improvements that are necessary for the property to fully comply with Agency standards for housing that is decent, safe, and sanitary. The covenant may use language in a State Supplement, similar to the following:

> "Pursuant to Section 510(e) of the Housing Act of 1949, as amended, 42 U.S.C. 1480, the purchaser ('Grantee' herein) of the above described property ('subject property' herein) covenants and agrees with the United States acting by and through the U.S. Department of Agriculture ('Grantor' herein) that the inadequate dwelling unit(s) located on the subject property as of the date of this quitclaim deed will not be occupied or used for residential purposes until the item(s) listed at the end of this paragraph have been accomplished. This covenant shall be binding on Grantee and Grantee's heirs, assigns, and successors and will be construed as both a covenant running with the subject property and as equitable servitude. This covenant will be enforceable by the United States in any court of competent jurisdiction. When the existing dwelling unit(s) on the subject property complies with the aforementioned standards of the U.S. Department of Agriculture in accordance with its regulations, the subject property may be released from the effect of this covenant and the covenant will thereafter be of no further force or effect. The property must be repaired as follows:_____." (insert the items referenced in the notice of sale and sale contract, necessary for the property to meet decent, safe, and sanitary standards)

C. Release of Restrictive Covenant

When the owner requests a release of the restrictive covenant, the Agency inspects the property. The Agency will release the covenant if the conditions that prohibited occupancy have been corrected; the specific items necessary for the property to meet decent, safe, and sanitary standards have been provided; or the structure necessitating the restrictive covenant has been removed from the site. Restrictive covenants, established as environmental mitigation measures, will not be released without the concurrence of the State Environmental Coordinator.

14.18 DISPOSITION BY PUBLIC DRAWING

Public drawing is the preferred and most common method of sale for REO properties. Exhibit 14-4 outlines the public drawing process. Use of any other sale method requires approval from the State Office.

Exhibit 14-4 The Disposition by Public Drawing Process	
Step 1	The property is offered for sale at market value. Loan Servicer completes *Form RD 1955-40, Notice of Real Property for Sale*.
Step 2	The Loan Servicer advertises the property. Contacting known interested parties is part of advertising efforts. Program properties are offered exclusively to program applicants for the first 45 days, after which the property is available to anyone. The Agency may accept offers from program applicants prior to the advertised drawing date. Non-program purchase offers cannot be accepted prior to the drawing date.
Step 3	Offers are accepted and stamped with the date and time of receipt.
Step 4	Agency reviews offers. If only one offer is received and the offer meets Agency requirements, that single offer may be accepted. If more than one offer is received, the Agency will accept the offer that is in the best interest of the Government. If acceptable offers are comparable, these will be sealed, placed in a receptacle, and drawn sequentially.
Step 5	If no acceptable offer is received, reduce price by 10 percent or use other incentives. Repeat steps 1 through 4.
Step 6	If no acceptable offer is received, submit REO case file with documentation of marketing efforts to the State Office for further advice on sales incentives or to authorize sealed bid/auction. Loan Servicer may reevaluate whether the project should be classified as a program property.

A. Listing the Property

REO property is offered for sale using *Form RD 1955-40.* The date indicated on *Form RD 1955-40* is the effective date of the offer. An offer may be submitted at any time after the effective date listed in the notice.

When an offer is accepted, the notice of sale is revised to indicate that only back-up offers will be taken. The notice is not withdrawn until the sale is closed, except when the offer is from a nonprofit organization or a public body for transitional housing for the homeless.

REO Property Subject to Redemption Rights

REO property subject to redemption rights may still be sold if Field Office Staff determine that there is no probability of its redemption and state law permits its sale. In states where such sales are permitted, a State Supplement will be issued with the specific state law requirements. The buyer must sign a statement acknowledging sale conditions under state law. The original signed statement will be filed in the REO case file and transferred to the borrower's case file if it is Agency financed.

B. Submission Requirements

An offer to buy must be submitted on *Form RD 1955-45, Standard Sales Contract, Sale of Real Property of the United States.* Offers received in any other form must be returned to the offeror. Any offer to buy that is contingent upon Agency credit must be accompanied by a completed *Form SF 424, Application for Federal Assistance.* Applications are considered completed and acceptable only if they include the required attachments. To establish borrower eligibility, the following attachments must be included when the application is submitted:

- Financial statements for the past two years;
- Credit report for each general partner (if limited partnership) or each officer (if corporation);
- Proposed limited partnership agreement and certificates of limited partners, if applicable;
- Tax-exempt ruling from the IRS designating the borrower organization as a 501(c)(3) or 501(c)(4) if applicant is nonprofit (if designation is pending, a copy of the designation request);
- Mission statement;
- Evidence of organization under state and local law or copies of pending applications; and
- List of board members

Those requesting Agency credit must meet the applicant eligibility requirements as outlined in Paragraph 4.16 of HB-1-3560.

C. Receiving and Considering Offers

Each offer must be date stamped when it is received. Offers received on the same day will be selected for consideration by lot. Names will be placed in a receptacle, drawn, and numbered sequentially. Offers drawn after the first are held as backup and the offeror so notified.

The Agency selects the first minimum acceptable offer received and executes *Form RD 1955-45*. The form is then sent to the bidder along with a letter to indicate acceptance of the offer. A letter is also sent to notify all unsuccessful bidders of the status of their offers.

D. Cancellation of Sales Contracts

If an offer contingent upon obtaining Agency financing on program terms is selected and the credit request is subsequently rejected, the next offer is considered. Property is not held off the market pending the outcome of an appeal. If there are no backup offers, the notice of sale is revised to indicate the new status of the property.

When a sales contract is canceled due to offeror default, any earnest money collected is forwarded to the Field Office where it will in turn be forwarded to the St. Louis Office for application to the General Fund.

14.19 DISPOSITION BY SEALED BID OR AUCTION

Any use of the sealed bid or auction methods must be authorized by the State Director. Program properties may be sold using these methods only after regular sales efforts have been unsuccessful for six months. Either method may be used as the initial sale effort for non-program properties when regular sale efforts are not likely to result in prompt sale (such as when structures have been substantially destroyed by fire).

A. Establishing the Minimum Acceptable Offer

Field Office Staff must develop and document the recommendation for the minimum acceptable bid or sales price using the net recovery value worksheet provided in Chapter 12, **Attachment 12-A**.

B. Publicizing the Sale

The Agency solicits sealed bids or publicizes an auction by public notice. The notice must include the date, time, and place of the bid opening or auction and describe how bids are to be made, the required percentage of bid deposit, the maximum credit terms, the cash preference percentage described in subparagraph C.3 of this section, and other pertinent information, such as a notice of special flood or mudslide hazard area or wetland and any related use restrictions.

C. Sealed Bid Procedures

1. Submission Requirements

Sealed bids must be made on *Form RD 1955-46, Invitation, Bid, and Acceptance, Sale of Real Property of the United States*, and be accompanied by a deposit provided in the form specified in the bidding instructions. No deposit is required from bidders who are eligible program purchasers. A minimum deposit of 10 percent is required for non-program loans.

Bidders must submit their bids in a sealed envelope marked: "SEALED BID OFFER _____* " (*insert Property Identification Number).

Bids may be submitted for individual properties or a group of properties.

2. Receiving and Opening Bids

All bids will be date and time stamped when they are received. Sealed bids will be held in a secured file before bid opening. If the bidder wants to withdraw their bid, this must be done prior to the drawing date. The bid opening will be held publicly at the place and time specified in the notice with at least two Agency employees present. Each bid received will be recorded showing the name and address of the bidder, the amount of the bid, the amount and form of deposit, and any conditions of the bid. The record of bids will be signed by the staff person conducting the bid opening and retained in the REO file.

3. Reviewing and Accepting Bids

Only responsive bids will be considered. To be considered responsive, bids must be signed and dated by the offeror, include any required deposit, and be for an amount at least equal to the established minimum bid. Minor deviations or defects in the bid submission may be waived by the Approval Official so long as the bid meets these minimum requirements.

Generally, the highest bid will be selected. However, cash bids will be given preference over bids that are contingent upon the offeror obtaining financing if the cash offer is at least equal to a specified percentage of the highest offer. Exhibit B of RD Instruction 440.1 specifies the applicable percentage.

In the case of two identical bids for a program property, program-eligible purchasers will be selected before bidders who are not program-eligible.

4. No Acceptable Bid

If no acceptable bids are received, the Agency may negotiate a sale at the best price possible in accordance with Paragraph 14.20. All bidders must be informed, in writing, of any anticipated negotiations. Deposits must be returned to all bidders by certified mail, return receipt requested.

5. Notification to Bidders

Field Office Staff also must notify unsuccessful bidders in writing that their bids were not accepted and who the successful bidder was. Deposits must be returned to all unsuccessful bidders by certified mail, return receipt requested.

When a bid is accepted, Field Office Staff must execute *Form RD 1955-46* and send a written acceptance of the bid.

6. Failure to Close

If a successful bidder fails to perform under the terms of the offer, for any reason other than denial of credit by the Agency, the bid deposit will be forfeited and forwarded to the St. Louis Office for application to the General Fund.

Upon determination that the successful bidder will not close, the State Director may authorize direct negotiations with the next highest bidder, authorize another sealed bid sale, or authorize negotiations with other interested parties, as described in Paragraph 14.20.

D. Auction Procedures

The State Director will determine whether an Agency employee will conduct the auction or whether the complexity of the sale requires the services of a professional auctioneer. *Form RD 1955-46* is used for auction sales.

1. Selecting a Professional Auctioneer

Auctioneers are selected through a competitive process using the procedures described in RD Instruction 2024-A. The commission will be set as part of the auctioneer solicitation. If an auctioneer submits a bid with a commission rate that is significantly lower than other bids, detailed documentation will be provided attesting that they have successfully sold properties at the lower rate with no compromise in service.

2. Bid Deposits

Successful bidders will be required to make a bid deposit of 10 percent of the purchase offer. This fee will be waived for program-eligible bidders, pending final determination of eligibility. Deposits should be in the form of cashier's check, certified check, postal or bank money order, or bank draft payable to the Agency. Cash and/or personal check may be accepted only if deemed necessary for a successful auction to occur by the person conducting the auction.

Where program financing is authorized, all notices and publicity should provide for a method of prior approval of credit and the credit limit for potential program-eligible purchasers. This may include submission of letters of credit or financial statements prior to the auction. The auctioneer should not accept bids that request program financing in excess of the market value.

3. Accepting Bids

When the highest bid is lower than the minimum amount acceptable to the Agency, negotiations should be conducted with the highest bidder or, in turn, the next highest bidder(s) or other persons known to be interested in obtaining an executed bid at the predetermined minimum.

4. Purchaser's Default

Upon purchaser's default, the Field Office Staff will remit the bid deposit to the St. Louis Office as a miscellaneous collection. The property may than be disposed of through a negotiated sale.

14.20 NEGOTIATED SALE

If no acceptable bid is received either from a sealed bid sale or at a public auction, the State Director may negotiate a sale at the best price possible without further public notice by negotiating with interested parties, including previous bidders.

A sale made through negotiation will be documented and accepted by the Approval Official on *Form RD 1955-46* and must be accompanied by a bid deposit of 10 percent of the negotiated sales price, except that the deposit will be waived for program-eligible buyers.

14.21 DISPOSAL OF PROPERTY FOR SPECIAL PURPOSES

REO properties may benefit people in need of housing who can be reached in cooperation with other programs or Federal agencies. Cooperative agreements with other Federal or state-assisted housing programs will be announced and updated with administrative notices.

14.22 DISPOSAL AS CHATTEL OR SALVAGE

If the Agency is unable to sell non-program property by regular sale, sealed bid, or public auction, the structure may be sold as chattel or salvage to be removed from the site. *Form RD 1955-47* is used to transfer title of real property converted to chattel to the purchaser.

If no offer is received to remove the structure, the State Director may contract or arrange to have it demolished, in exchange for the salvaged materials or otherwise as determined appropriate. For example, the local fire fighting unit may be permitted to use a structure slated for demolition as a burn for fire fighting practice. Once the structure is disposed of, the lot is offered for sale as non-program REO property.

If REO property is a vacant lot, the lot is offered for sale as non-program property.

SECTION 3: ENVIRONMENTAL REQUIREMENTS

14.23 OVERVIEW

The Agency must complete the appropriate level of environmental review under the National Environmental Policy Act for disposal of REO property in accordance with RD Instruction 1940-G. The proposed disposal of REO property will normally qualify as a categorical exclusion. However, an environmental assessment and an environmental impact statement (EIS), when deemed necessary, is required for any proposed disposal of REO property that meets one of the following criteria:

- The Agency has evidence that the transaction would result in a change in use of the REO property (e.g., the property is being sold as non-program and the application for Agency financing indicates that it will be used for commercial use);
- The transaction is controversial for environmental reasons;
- The property is located within a special flood or mudslide hazard area or contains a wetland;
- The property is located within the Coastal Barrier Resources System;
- The property is listed or eligible for listing on the National Register of Historic Places;
- The property contains reportable underground storage tanks; or
- The property is contaminated with hazardous substances or petroleum products.

This section summarizes the basic environmental information that pertains to disposal of REO properties. For more detailed information and assistance, refer to RD Instruction 1940-G or consult the State Environmental Coordinator.

14.24 PROPERTY LOCATED WITHIN A SPECIAL FLOOD OR MUDSLIDE HAZARD AREA OR CONTAINS WETLANDS

REO property located in a special flood or mudslide hazard area will not be sold for residential purposes unless it is determined safe—that is, any danger that exists by virtue of the floodplain location is not likely to endanger the health or safety of the occupants—and prior written notice of the specific hazard is given.

Form RD 1955-46 must include notice of special flood or mudslide hazard areas or wetlands and related use restrictions. Prospective purchasers, auctioneers, and brokers must be informed and acknowledge receipt of notice of these circumstances, and all advertisements need to reference them.

The conveyance instrument for disposal of REO property containing wetlands or located in a special flood or mudslide hazard area must specify those uses of the property that are restricted under any Federal, state or local floodplain and wetland regulations, as well as other relevant restrictions. Use restrictions will relate to the use of the property by the purchaser and any successors as determined by the Agency. Examples of use restrictions include prohibition of draining or filling of floodplain or wetland areas, prohibition of new aboveground construction on that portion of the property located in the floodplain or wetland area, and prohibition against subdividing floodplain or wetland property into building lots.

14.25 COASTAL BARRIER RESOURCES SYSTEMS

REO property located within a CBRS will not be sold until the State Environmental Coordinator has consulted with the appropriate USFWS Regional Director, and the Regional Director concurs that the proposed sale does not violate the provisions of the CBRA.

No Federal financing is permitted for REO property located within a CBRS, since flood insurance under the National Flood Insurance Program is not available for properties within the CBRS.

14.26 NATIONAL REGISTER OF HISTORIC PLACES

When REO property has been determined to be listed on (or eligible to be listed on) the National Historic Register, the Loan Approval Official responsible for conveyance must consult with the SHPO to establish any necessary restrictions on the use of the property so that the future use will be compatible with preservation objectives, as long as it does not result in an unreasonable economic burden to public or private interest. The Advisory Council on Historic Preservation must be consulted by the Loan Approval Official after the discussions with the SHPO are concluded.

Any restrictions that are developed on the use of the property as a result of the above consultations must be made known to potential bidders or purchasers through all advertisements and notices regarding the property, as well as in writing when the prospective purchaser signs the bid or offer to purchase. Acknowledgment of receipt of this notice will be obtained from the purchaser at that time and kept in the REO case file.

14.27 PROTECTIVE COVENANTS AND EASEMENTS

The Agency has an affirmative responsibility to take actions to protect environmental resources located on REO property before that property is disposed of. "Affirmative responsibility" refers to the fact that there are certain protections that are required by Federal, state, or local environmental laws. Frequently such protective actions or mitigation measures will take the form of a covenant or conservation easement. In addition to floodplains, wetlands, coastal barriers, and historic places, this affirmative responsibility also extends to the following resources:

- Listed or proposed endangered or threatened species;
- Listed or proposed critical habitat;

- Designated or proposed wilderness areas;
- Designated or proposed wild or scenic rivers;
- Natural landmarks listed in the National Register of Natural Landmarks;
- Sole source aquifer recharge areas designated by EPA;
- Designated national trails;
- Important farmland; or
- Areas of high water quality.

The State Environmental Coordinator should be consulted if it appears that the proposed disposal of REO property may involve any of these resources.

14.28 REPORTABLE UNDERGROUND STORAGE TANKS

When disposing of REO property containing reportable underground storage tanks as described in Paragraph 14.9(A)(4) of this chapter, the Agency, if it has not already done so, must file the appropriate report with the State agency identified by the EPA. The potential purchaser of the property will be informed by the Loan Approval Official of the reporting requirement and provided a copy of the filed report.

14.29 MANAGEMENT OF HAZARDOUS SUBSTANCES AND PETROLEUM PRODUCTS

All property considered for disposal must be evaluated for possible hazardous substance contamination. To do this, the Loan Approval official completes the *TSQ*, the initial level of inquiry in the due diligence process. (If a TSQ was completed prior to acquisition of the property, the Approval Official must determine if the TSQ should be updated.) If the completed or updated TSQ indicates potential contamination, it will be sent promptly to the State Environmental Coordinator for further evaluation and guidance. All cleanup actions, if appropriate, will be taken under the guidance of the State Environmental Coordinator.

When leasing REO property, in whole or part, Field Office Staff must in all cases notify potential lessees of the risk for potential contamination from hazardous substances, hazardous wastes, or petroleum products by providing the lessee with a copy of the Agency's due diligence report on the property acquisition. The due diligence report should be accompanied by a written disclaimer to the effect that the Agency does not provide any guarantee as to the accuracy of the report, but is simply making the results of its inquiry public.

A Covenant Regarding Hazardous Substance Remediation is provided as **Attachment 14-B**.

14.30 LEAD-BASED PAINT

The Agency must eliminate the hazards of lead-based paint poisoning in all REO properties before sale if they are to be used for residential purposes. Obligations include inspecting surfaces constructed prior to 1978 to determine whether there are defective paint surfaces and treating surfaces found to contain lead-based paint to eliminate hazards. Prospective purchasers must be notified of the results of the inspection. **Attachment 14-C** includes basic guidance about lead-based paint requirements, including disclosure, and a sample disclosure format to provide purchasers with information about known lead-based paint hazards in the property.

SECTION 4: PROCESSING AND CLOSING

14.31 OVERVIEW

If the Agency is closing the sale with program financing, the sale is closed in accordance with program closing instructions provided in Chapter 8 of HB-1-3560. If other financing is being used, the financing agent's closing procedures should be followed. Cash sales are closed by the Agency collecting the sale price and delivering the quitclaim deed to the buyer.

Title clearance and property insurance requirements for a program-financed sale are the same as for a program loan.

14.32 SPECIAL NOTICES AT SALE

In accordance with the Residential Lead-Based Paint Hazard Reduction Act of 1992, sellers of housing built before 1978 receiving Federal assistance must provide the purchasers of such housing with specific information about the housing's lead history and general information on lead exposure prevention. As seller the Agency must:

- Provide the buyer with the lead hazard information pamphlet, *Protect Your Family from Lead in Your Home*, available from the National Lead Information Clearinghouse at 1-800-424-LEAD, or a similar EPA-approved pamphlet developed by the State;

- Permit the buyer a 10-day opportunity to conduct a risk assessment or inspection for the presence of lead-based paint hazard; and

- Include in the sales contract: (1) disclosure of any lead-based paint hazard or a statement that the Agency has no knowledge of such hazard; (2) a list of any information about the hazard available to the seller and passed on to the buyer; and (3) a Lead Warning Statement and acknowledgment, signed by the buyer. A sample disclosure format, including the required Lead Warning Statement, is provided in **Attachment 14-C**.

14.33 INSPECTION

An inspection of the property by the buyer should be scheduled immediately before closing to ensure satisfactory condition of the property and the resolution of any problems or discrepancies.

14.34 PRORATING REAL ESTATE TAXES AND/OR ASSESSMENTS

When REO property is subject to taxation and/or assessment, they are prorated between the Agency and the buyer, as of the date the title is conveyed. The Agency is responsible for all taxes and assessments accrued as of the settlement date, and the buyer is responsible for all taxes and assessment that accrue after the closing date. The Agency's pro rata share is deducted from

the proceeds of the sale at closing, if sufficient funds are available, or is paid under RD Instruction 2024-A.

14.35 COMMISSIONS

Commissions are paid at closing if there is sufficient cash from sale proceeds to cover the commission. If not, the Agency will pay the commission and charge it to the REO account as a recoverable cost.

14.36 TRANSFERRING TITLE

The Agency conveys the property to the buyer by *Form RD 1955-49, Quitclaim Deed*, or other form of non-warranty deed approved by OGC. The State Director signs the conveyance instrument, a copy of which is retained in the REO case file. The buyer is responsible for recording the instrument.

14.37 REPORTING SALE

When the transaction is closed and the conveying instrument has been delivered, the disposition is recorded in the REO system. Real property that has been disposed of by means other than sale, including total loss or destruction, will also be reported in the REO system. Sale proceeds are forwarded to the St. Louis Office to be credited to the General Fund.

SECTION 5: PROCESSING CREDIT SALES ON NON-PROGRAM TERMS

14.38 OVERVIEW

The sale of non-program properties is conducted in a manner similar to other sales; however, there are some differences in the terms of the sale, the processing of the offers, loan closing, and the treatment of the property after the sale is complete. This section highlights these differences. See HB-1-3560 for processing credit sales for program properties.

14.39 TERMS OF A NON-PROGRAM CREDIT SALE

The following provisions apply to credit sales on non-program terms.

- **Interest rate.** The Section 515 interest rate plus 0.5 percent will be charged on all types of housing credit sales. Refer to Exhibit B of RD Instruction 440.1 (available in any Field Office) for interest rates. Loans made on non-program terms will be equal to the lesser of the prevailing interest rate at the time of loan approval or loan closing; and

- **Term of note.** The note amount will be amortized over a period not to exceed 10 years. If the State Director determines more favorable terms are necessary to facilitate the sale, the note amount may be amortized using a 30-year factor with payment in full (balloon payment) due not later than 10 years from the date of closing. In no case will the term be longer than the period for which the property will serve as adequate security.

Agency loans to finance the purchase of non-program REO property are subject to the availability of funds.

Each tenant in an REO property designated to be sold as a non-program property will be notified by the Agency, in writing, of the housing project's non-program designation and will be given an opportunity to obtain a Letter of Priority Entitlement (LOPE).

14.40 ACCEPTING OFFERS

The sale of a non-program property is similar to other sales. Field Office Staff publicize the sale, accept bids, and choose a bid from the first acceptable bids received.

- **Documenting offers and acceptance.** Field Office Staff must use *Forms RD 1955-45* and *1955-46*, as appropriate, to document the offer and acceptance. Field Office Staff must accept the contract prior to processing a request for credit on non-program terms.

- **Cash sales.** If the offeror can purchase the property without Agency assistance, Field Office Staff will simply collect the purchase price (less any deposits) and deliver the deed to the purchaser.

- **Purchase with non-program credit.** Purchasers requesting credit on non-program terms will be required to submit documentation to establish financial stability, repayment ability, and creditworthiness:

  ◊ The borrower may submit the standard forms used to process program applications or comparable documentation. Field Office Staff may request additional information as needed to support loan approval.

  ◊ Field Office Staff will order individual credit reports for each individual applicant and each principal within an applicant entity. Commercial credit reports will be ordered for profit corporations and partnerships, and organizations with a substantial interest in the applicant entity.

14.41 APPROVAL

Field Office Staff must use *Form RD 3560-51* to approve a credit sale even though no obligation of funds is involved. For guidance on how to complete the form, see the special instructions on the FMI pertaining to non-program credit sales.

The Loan Servicer must review *Form RD 1910-11* with the applicant, and the form must be signed by the applicant.

14.42 CLOSING SALE

The Loan Servicer will provide the closing agent with necessary information for closing the sale. Title clearance, loan closing, and property insurance requirements for a credit sale are similar to those for program loans. As for program sales, OGC assistance will be requested to provide closing instructions.

The following are the highlights of the closing process for non-program sales:

- **Closing costs.** The purchaser will pay their own closing costs. Earnest money, if any, will be used to pay purchaser's closing costs with any balance of closing costs being paid by the purchaser. Any closing costs which are legally or customarily paid by the seller will be paid by the Agency from the down payment;

- **Down payment.** A down payment of not less than 10 percent of the purchase price is required at closing and will be remitted by the Field Office Staff;

- **Modification of security instruments.** Field Office Staff must modify security instruments as necessary:

  ◊ On the *Form RD 3560-52, Promissory Note* and/or security instrument (mortgage or deed of trust) any covenants relating to graduation to other credit, restrictive-use provisions, personal occupancy, inability to secure other financing, and restrictions on leasing may be deleted; and

◊ Deletions are made by drawing a line through the specific inapplicable language. The borrower and an Agency representative must initial the changes.

- **Purchase of more than one property.** When more than one property is bought by the same buyer and the transactions are closed at the same time, a separate *Form RD 3560-52* will be prepared for each property, but one mortgage will cover all the properties; and

- **Reporting sale.** When the transaction is closed and the conveying instrument has been delivered, Field Office Staff will report the sale like all other sales. They will process *Form RD 3560-19, Status of REO Property,* in accordance with the respective FMI.

14.43 SERVICING THE NON-PROGRAM LOAN

Credit sales on non-program terms will be classified as non-program loans and serviced accordingly. The project is not subject to any rent, occupancy, or other program requirements.

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ATTACHMENT 14-A

UNDERGROUND STORAGE TANKS THAT MUST BE REPORTED

A. Underground storage tanks that meet the following criteria must be reported in two types of situations.

1. **Situation 1**

- A tank, or combination of tanks (including pipes which are connected thereto), of which the volume is 10 percent or more beneath the surface of the ground, including the volume of the underground pipes;

- The tank is not exempt from reporting requirements under Paragraph B below; and

- The tank contains petroleum or substances defined as hazardous under Section 101(14) of the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. 9601. The State Environmental Coordinator should be consulted whenever there is a question regarding the presence of a regulated substance.

2. **Situation 2.** It is known that the tank contained a regulated substance, was taken out of operation by the Agency since January 1, 1974, and remains in the ground. Extensive research of records of inventory property sold before the effective date of this section is not required.

B. Underground storage tanks that are exempt from the EPA reporting include:

- Farm or residential tanks of 1,100 gallons or less capacity used for storing motor fuel for noncommercial purposes;

- Tanks used for storing heating oil for consumptive use on the premises where stored;

- Septic tanks;

- Pipeline facilities (including gathering lines) regulated under: (1) the Natural Gas Pipeline Safety Act of 1968; (2) the Hazardous Liquid Pipeline Safety Act of 1979; or (3) for an intrastate pipeline facility, regulated under State laws comparable to the provisions of law referred to in (1) or (2);

- Surface impoundments, pits, ponds, or lagoons;

- Storm water or wastewater collection systems;
- Flow-through process tanks;
- Liquid traps or associated gathering lines directly related to oil or gas production and gathering operations; or
- Storage tanks situated in an underground area (such as a basement, cellar, mineworking, drift, shaft, or tunnel) if the tank is situated upon or above the surface of the floor.

Even if a storage tank does not need to be reported according to these criteria, if the Agency has reason to believe there has been a release of petroleum or other regulated substance from an underground storage tank on a REO property, this incident must be reported to the appropriate State Agency and the State Environmental Coordinator, who will inform the State Office of the appropriate action to take.

ATTACHMENT 14-B

COVENANT REGARDING HAZARDOUS SUBSTANCE REMEDIATION

(1) The United States, acting through the (Agency name), warrants that all remedial action necessary to protect human health and the environment with respect to any such substance remaining on the property herein leased, transferred, or conveyed has been taken before the date of this lease, transfer or conveyance.

(2) If lessor or transferee finds that additional remedial action is necessary to protect the human health and the environment after the date of this lease, transfer or conveyance, the United States, acting through the (Agency name), will conduct such action.

(3) The hazardous substance remediation requirements described herein do not apply when the property is leased, transferred, or conveyed to a potentially responsible party.

(4) The lessee or transferee herein, hereby grants to the United States, acting through the (Agency name), access to the property in any case in which remedial or corrective action is found to be necessary.

Note: If the lessee or transferee is a potentially responsible party (PRP), the Notification: Hazardous Substance Activity must be given, but the Covenant Regarding Hazardous Substance Remediation (Attachment 14-B) does not need to be included with the transfer.

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ATTACHMENT 14-C

LEAD-BASED PAINT DISCLOSURE FORM

Disclosure Form for Target Housing Sales

Disclosure of Information on Lead-Based Paint and/or Lead-Based Paint Hazards

LEAD WARNING STATEMENT

Every purchaser of any interest in residential real property on which a residential dwelling was built prior to 1978 is notified that such property may present exposure to lead from lead-based paint that may place young children at risk of developing lead poisoning. Lead poisoning in young children may produce permanent neurological damage, including learning disabilities, reduced intelligence quotient, behavioral problems, and impaired memory. Lead poisoning also poses a particular risk to pregnant women. The seller of any interest in residential real property is required to provide the buyer with any information on lead-based paint hazards from risk assessments or inspections in the seller's possession and notify the buyer of any known lead-based paint hazards. A risk assessment or inspection for possible lead-based paint hazards is recommended prior to purchase.

SELLER'S DISCLOSURE (INITIAL)

_____(a) Presence of lead-based paint and/or lead-based paint hazards (check one below):

☐ Known lead-based paint and/or lead-based paint hazards are present in the housing (explain).

_____

_____

_____

☐ Seller has no knowledge of lead-based paint and/or lead-based paint hazards in the housing

_____(b) Records and reports available to the seller (check one below):

☐ Seller has provided the purchaser with all available records and reports pertaining to lead-based paint and/or lead-based paint hazards in the housing (list documents below).

_____

_____

_____

☐ Seller has no reports or records pertaining to lead-based paint and/or lead-based paint hazards in the housing.

☐ Purchaser's Acknowledgment (initial)

_____ (c) Purchaser has received copies of all information listed above.

_____ (d) Purchaser has received the pamphlet *Protect Your Family From Lead in Your Home*.

_____ (e) Purchaser has (check one below):

☐ Received a 10-day opportunity (or mutually agreed upon period) to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards; or

☐ Waived the opportunity to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards.

AGENT'S ACKNOWLEDGMENT (INITIAL)

____ (f) Agent has informed the seller of the seller's obligations under 42 U.S.C. 4852d and is aware of his/her responsibility to ensure compliance.

CERTIFICATION OF ACCURACY

The following parties have reviewed the information above and certify, to the best of their knowledge, that the information provided by the signatory is true and accurate.

_____	_____	_____	_____
Seller	Date	Seller	Date
_____	_____	_____	_____
Purchaser	Date	Purchaser	Date
_____	_____	_____	_____
Agent	Date	Agent	Date

CHAPTER 15: PROJECT PRESERVATION

15.1 INTRODUCTION

Some borrowers may want to prepay their Agency loans and convert their properties to conventional use. To protect the supply of affordable housing and to ensure that tenants of multi-family housing properties do not suffer from rent overburden or lose their units, the Agency requires that borrowers obtain approval before prepaying their loans *[7 CFR part 3560, subpart N]*. The approval process allows the Agency to offer the borrower incentives to forgo prepayment and maintain the affordability of the housing. This chapter explains prepayment requirements and describes the prepayment request and approval process.

15.2 OVERVIEW OF THE CHAPTER

The key decision points in the prepayment process are shown in Exhibit 15-1 of this section. For an overview of the process, see **Attachment 15-A**.

This chapter addresses the process in five parts:

- Section 1 outlines the key eligibility requirements for participating in the process and obtaining approval to prepay.
- Section 2 describes requirements and procedures for processing and evaluating prepayment requests for loans closed before 1979 or loans with no restrictive agreements.
- Section 3 describes requirements and procedures for processing and evaluating prepayment requests for loans closed between 1979 and 1989 that have restrictive agreements. This section also describes the process of offering the property for sale to nonprofit organizations and public agencies.
- Section 4 discusses properties subject to special circumstances, including foreclosure, bankruptcy, acceleration, and the advance payment of accounts.

Office of Rental Housing Preservation (ORHP)

ORHP was established to ensure a standard approach to the prepayment decision-making process. ORHP will approve all incentive offers made by the Field Offices and authorize the closing of these offers.

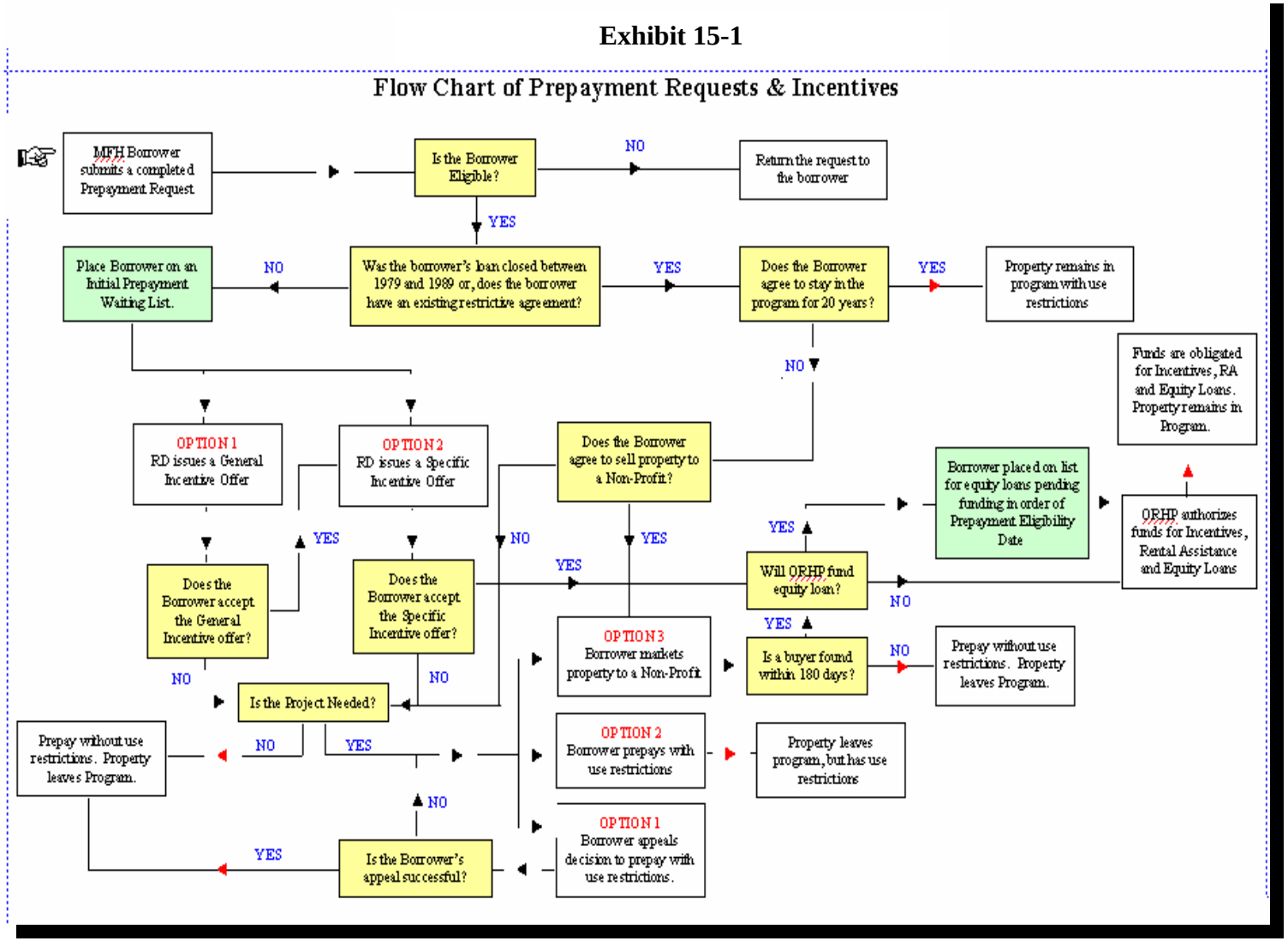
Through Prepayment Tracking and Concurrence (Pre-Trac), ORHP should be kept informed of the prepayment request's progress through the process. Field Offices should inform ORHP when:

- A prepayment request is received;
- A request is to be removed from the list;
- An incentive offer is developed and ready for ORHP approval before being offered;
- A borrower accepts incentives;
- A borrower rejects an incentive offer;
- The State Office is ready to process a transfer to a nonprofit or public body; or
- The State Office requests prepayment with or without restrictive-use provisions (RUPs).

Loan Servicers should use Pre-Trac, which is an Internet-ready database application that allows Loan Servicers to process multi-family housing prepayment requests.

Exhibit 15-1

Flow Chart of Prepayment Requests & Incentives



SECTION 1: PRESERVATION AND ELIGIBILITY FOR PREPAYMENT

15.3 OVERVIEW

This section covers key eligibility requirements that apply to prepayment process, including:

- Determining eligibility to submit a prepayment request;
- Meeting with the borrower;
- Notifying tenants;
- Receiving a prepayment request and conducting a completeness review; and
- Determining prepayment feasibility.

15.4 BORROWERS ELIGIBLE TO REQUEST PREPAYMENT *[7 CFR 3560.652]*

Before submitting a prepayment request, borrowers should confirm that they are eligible to prepay and that they are required to submit a prepayment request. Loans made on or after December 15, 1989, to build or acquire new multi-family housing units are prohibited from prepayment.

15.5 MEETING WITH THE BORROWER

Whenever Loan Servicers receive an inquiry concerning prepayment, they should invite the borrower to a meeting. If the borrower begins the prepayment request process with an understanding of the steps involved and the incentives available, the process is more likely to proceed with fewer miscommunications and delays.

At the meeting, the Loan Servicer should:

- Provide the borrower with the items necessary to constitute a prepayment request in accordance with 7 CFR 3560.653 and review the list of items to be submitted. Answer any questions regarding the submissions. Make clear that a complete request includes evidence that the borrower is able to prepay the loan;
- Explain the prepayment process, including the procedures for requesting prepayment, the offer of incentives, and the sale to nonprofit organizations or public agencies;
- Recommend that the borrower hold a meeting with tenants to inform them of the prepayment request and explain the implications of the prepayment process for tenants. The borrower may invite other affordable housing agencies to this meeting to discuss options with the tenants. The Loan Servicer may attend this meeting as well;

- Describe the incentives that are available and explain that the offer will depend on the value of the borrower's project and its potential for conventional use (**Attachment 15-B** provides a description of incentives and the incentive development process that can be given to the borrower); and

- Explain the restrictive-use provisions that will apply if the borrower accepts the Agency's offer of incentives (see **Attachment 15-E**).

15.6 TENANT NOTIFICATION REQUIREMENTS *[7 CFR 3560.654]*

Throughout the prepayment process, the Agency and the borrower both have a responsibility to inform tenants of the status of the prepayment request.

Tenants are often alarmed by the prospect of prepayment and uninformed about its implications for their housing situation. The Agency recommends that owners hold a meeting early in the request process. Items to cover at such a meeting include:

- The meaning of the first tenant notification letter;
- The steps in the prepayment process;
- Potential outcomes for the property;
- Alternative housing options for the tenants; and

- **Initial notice.** Within 30 days of the receipt of a complete request, the Loan Servicer must send a notification to each tenant in the project. A sample letter is attached as **Attachment 15-C**.

  ◊ The Agency may deliver the notices to the borrowers by mail or directly.

  ◊ The Agency should also send copies of the notification to the borrower and the management agent because the borrower must post copies of the notifications in public areas in the project. These notices must remain posted until the next notice providing an update on the status of the prepayment request is sent.

  ◊ The borrower must provide copies of the notifications to any tenants who occupy units after these notices were sent.

- **Subsequent notices.** To keep the tenants informed of the progress of the prepayment request, additional notifications are sent after key decisions in the process are made. These notices should be sent, posted, and provided to new tenants, as described for the initial notice. A list of appropriate times to send these notices is provided in Exhibit 15-2.

- **Other interested parties.** Whenever Loan Servicers provide notices to tenants regarding the prepayment process, they must also notify other interested parties such as nonprofit organizations and public agencies.

Exhibit 15-2
List of Notices to be Provided to Tenants
During the Prepayment Process

The following notifications must be sent to tenants at the times indicated below. These notices must be sent to individual tenant households and posted in the project.

1. **Within 30 days of receipt of the prepayment request:**

   Tenant Notification #1: This notice must be sent within 30 days of receipt of a complete prepayment request. This letter informs tenants that the borrower has submitted a request to prepay. This letter may be coordinated with a meeting including the borrower, the tenants, and the Agency. *[7 CFR 3560.654(a)]*

2. **After a decision has been made to accept prepayment or offer incentives:**

   Tenant Notification #2A: If the borrower's prepayment request is withdrawn, the Loan Servicer will send a letter to the tenants informing them that prepayment will not take place. If there is an appeal, this letter should be delayed until the outcome of the appeal is known. *[7 CFR 3560.654(d)]*

   Tenant Notification #2B: If the borrower is permitted to prepay with or without use restrictions, the Loan Servicer will send a letter to the tenants informing them of the prepayment and providing them information on their rights (such as reimbursement of relocation costs). This letter must be sent 60 days prior to prepayment. *[7 CFR 3560.654(c)]*

3. **After the offer of incentives has been accepted or rejected:**

   Tenant Notification #3A: If the borrower accepts the incentives and related use restrictions, the Loan Servicer will send tenants a letter informing them of the outcome and describing the use restrictions. *[7 CFR 3560.654(e)]*

   Tenant Notification #3B: If the borrower rejects the incentives, the Agency will decide if prepayment will be accepted with or without use restrictions. The Loan Servicer will send letters to the tenants informing them that the borrower is prepaying with or without and explaining their rights under the use restrictions. This letter must be sent 60 days prior to prepayment. *[7 CFR 3560.654(c)]*

   Tenant Notification #3C: If the borrower chooses to offer the property for sale to a nonprofit organization or a public agency, the Loan Servicer will send a letter to the tenants informing them that the borrower is offering the property for sale and explaining the sale process. *[7 CFR 3560.654(f)]*

4. **After the offer for sale is complete:**

   Tenant Notification #4A: If the borrower does not receive a good faith offer within 180 days and is proceeding to prepay the loan, the Loan Servicer will notify tenants of the prepayment. This letter must be sent 60 days prior to prepayment (i.e., 60 days prior to the end of the 180-day marketing period). If a good faith offer is received within the final 60 days of the marketing period, a new letter must be sent to the tenants as described in Tenant Notification #4B. *[7 CFR 3560.654(h)]*

   Tenant Notification #4B: If a tenant applicant signs a lease in a housing project for which a prepayment request has been submitted, the borrower must provide the tenant with copies of all notifications provided to tenants by the Agency or the borrower prior to the tenant's occupancy in the housing project. *[7 CFR 3560.654(g)]*

15.7 REQUIREMENTS FOR PREPAYMENT REQUESTS *[7 CFR 3560.653]*

To be considered for prepayment, the borrower must submit a complete request at least 180 days before the expected date of prepayment. This time frame allows the Agency time to review the request, complete the applicable analyses, and offer incentives, if appropriate, prior to

the prepayment date. If all required procedures can be completed in fewer than 180 days, the prepayment may occur at an earlier date.

A copy of all items to be submitted by the borrower can be found in Pre-Trac on the Prepayment Application Checklist Screen**.**

Good Practice—Notification to Borrowers

Some borrowers may pay their loans on an accelerated schedule. As these borrowers approach 180 days from their last payment, the Agency should notify them of their status and of their obligation to submit a prepayment request. See paragraph 15.33 for more information on the advance payment of accounts.

15.8 RECEIPT OF PREPAYMENT REQUESTS

When a request for prepayment is received, the Loan Servicer must take the following steps to establish the date of receipt and begin a project file.

- Immediately upon receipt of a written prepayment request, date stamp the request and enter the date of receipt in Pre-Trac on the Timeline Screen at Activity A00. If the completeness review shows the request to be complete (as described in Paragraph 15.9) the date stamped on the request will be used as the date of receipt. (This date will be used by the ORHP to establish the borrower's position on the waiting list for incentives, if necessary.)
- Begin a project file. The Agency should have a separate file on each prepayment request that includes:
  - ◊ Application (with coversheet that summarizes all key project information);
  - ◊ Tenant notifications;
  - ◊ Project appraisal;
  - ◊ Documentation of all analysis performed;
  - ◊ Communications with the borrower; and
  - ◊ The mortgage document.
- Enter prepayment-related project data into Multi-Family Information System (MFIS) (MFIS) and Pre-Trac.

15.9 COMPLETENESS REVIEW

Within 10 days of receiving the prepayment request, the Loan Servicer must review it for completeness. This entails a brief look at the submission to ensure that all the items listed in the Pre-Trac Prepayment Application Checklist Screen are included.

- **Complete requests.** If the Loan Servicer determines that the request is complete, the Loan Servicer must:

◊ Send a letter to the borrower providing the date of receipt of the request, and informing the borrower that the Agency is reviewing the request and may ask for additional information;

◊ Send a letter to tenants informing them that the borrower has submitted a request to prepay. This letter must be sent within 30 days of receiving the request (as described in Paragraph 15.6). Also notify other interested parties at this time; and

◊ Complete a review of the request for the feasibility of prepayment. This review must be completed within 60 days of the receipt of the complete request and is described in Paragraph 15.10.

- **Incomplete requests.** If the Loan Servicer finds that all items are not included, the incomplete request must be returned to the borrower with a letter listing the missing items. The borrower may submit a new request to begin the prepayment request process again. The date of receipt cannot be established until a complete request is received.

15.10 DETERMINATION OF PREPAYMENT FEASIBILITY

To receive an offer of incentives, the borrower must demonstrate the ability to prepay the Agency loan. Within 60 days of the receipt of a complete application, the Loan Servicer must review the prepayment request to determine the feasibility of prepayment and enter the date of complete application into Pre-Trac on the Timeline Screen at Activity A06.

To determine the feasibility of prepayment, the Loan Servicer must review the borrower's ability to prepay. To be considered "feasible", the borrower must have the ability to prepay the loan, as discussed below. It is not in the Agency's interests to offer incentives to a borrower who does not have the financial capacity to prepay the loan since there is little risk that the borrower will actually prepay and remove the project from the program.

The borrower may be planning to finance the prepayment in one of three ways:

- From the borrower's own resources;
- With financing from a lender or other third-party; or
- By selling the project.

Regardless of the source of funds, the borrower must be able to show that the proposed source of financing is available. The Loan Servicer must review the borrower's prepayment request to ensure that the borrower has submitted sufficient evidence that the funding is available, as described below.

A. Borrower's Funds

If using their own funds, the borrower must provide:

- A balance sheet and income statement showing that sufficient cash is available to pay the loan principal or that assets of sufficient value are available and can be readily converted to cash; and

- Certification that the income or assets are not pledged elsewhere (e.g., to other prepayment requests or other loans).

B. Third-Party Lender

If obtaining a loan, the borrower must provide an original copy of the precommitment letter from the lender, stating:

- The rates and terms of loan;

- The amount financed; and

- A description of the security of the loan.

C. Sale

If the borrower is planning to sell the project, the borrower must submit a purchase agreement and documentation of the purchaser's ability to pay. The purchaser's ability to pay can be documented in the same manner as the borrower's, as described in Paragraph 15.10(A).

15.11 ELIGIBILITY DETERMINATION

If the Loan Servicer determines that the borrower is eligible with a complete prepayment request and prepayment is feasible, the Loan Servicer continues to process the request. If the borrower is not eligible for prepayment, the Loan Servicer notifies the borrower in writing stating the reasons that the borrower is not eligible for prepayment.

For loans that were closed prior to 1979, or if the loan does not have any existing restrictive agreements, the Loan Servicer follows the process described in Section 2 of this chapter. If the borrower's loan closed between 1979 and 1989 and has a restrictive agreement, the Loan Servicer follows the process described in Section 3 of this chapter.

SECTION 2: LOANS CLOSED BEFORE 1979 OR LOANS WITH NO RESTRICTIVE AGREEMENTS

15.12 PREPAYMENT WAITING LIST

For borrowers who meet the eligibility requirements of Section 1 of this chapter and who have loans that closed prior to 1979 or have no restrictive agreements, the Loan Servicer will place the borrower on an initial prepayment waiting list using Pre-Trac.

15.13 MAKING THE INCENTIVE OFFER—OVERVIEW

To encourage borrowers to forgo prepayment, the Agency offers incentives to all borrowers applicable under this section. Paragraphs 15.14 through 15.21 of this section describe the process for offering incentives and responding to the borrower's acceptance or rejection of Agency incentives.

15.14 GENERAL INCENTIVE OFFER

At the discretion of the Agency, the Loan Servicer may make a general incentive offer to the borrower before developing the specific incentive package. The Loan Servicer should make a general offer only if the borrower indicates that any specific incentive offer will be rejected. From the date of the general offer, the borrower has 30 calendar days to accept or reject the offer.

- If the borrower rejects the general offer in writing, the Agency will not develop a specific incentive offer. The Agency will determine the impact of prepayment as described in Paragraph 15.22.

- If the borrower accepts the general offer, the Agency will develop a specific incentive offer in accordance with this section.

- If the borrower rejects the general offer in writing after 30 calendar days, the Agency will not complete the specific incentive offer and will consider all incentives rejected.

15.15 SPECIFIC INCENTIVE REQUIREMENTS *[7 CFR 3560.656]*

Specific incentive offers are subject to the following requirements.

- **Value of incentive offer.** The incentive offer must be based on the Agency's assessment of:

  ◊ The amount necessary to provide a fair return on the investment of the borrower;

  ◊ An amount that will not cause project rents to increase above the Conventional Rents for Comparable Units (CRCU) standard in accordance with Chapter 4 of HB-2-23560; and

  ◊ The least costly alternative for the Federal Government that is consistent with extending the low-income use of the property.

- **Eligible recipients.** The Agency will offer incentives only to borrowers who have met the requirements outlined in Section 1 of this chapter.

- **Time frame for offer response.** The Agency must develop the offer within 60 days of completing the review for feasibility and impact. The borrower must respond to an incentive offer within 30 calendar days. If no answer to the offer is received within 30 calendar days, the Agency must consider the incentive offer rejected.

- **Reserve requirements.** At the time the incentive is developed, the maximum reserve amount must be adjusted to include the costs of any deferred maintenance items or expected long-term repair or replacement costs of the project based on the project's capital plan. The Agency may require an additional deposit to the reserve account from the incentive package and/or reduce the incentive in order to allow rents to be increased to fund the reserve at a level necessary to meet capital needs.

- **Capital Improvements.** Any necessary capital improvements must be addressed (monies set aside) prior to receiving any incentives.

- **Consolidation and reamortization of loans.** If a project has more than one Agency loan, existing project loans must be consolidated and reamortized unless consolidation is not necessary to maintain feasibility of the project for the current tenants or the level of monthly rental subsidies must be reduced.

- **Appraisal requirements.** An appraisal is required to provide the Agency the information needed to establish the appropriate value of the incentive offer. It is the Agency's responsibility to assure that an appraisal is obtained.

15.16 TYPES OF INCENTIVES *[7 CFR 3560.656(c)]*

The Agency may offer the borrower one or more of the items discussed below as incentives to forgo prepayment. The following considerations apply to the development of the incentive package:

- Incentive offers must not be made without sufficient rental assistance to protect current tenants against rent overburden;

- If the incentive package involves a rent increase, the Agency must approve the rent increase in accordance with budget approval procedures outlined in Chapter 4 of HB-2-3560. In no case may the rent increase cause rents to increase above the CRCU standard as discussed in Chapter 4 of HB-2-3560 *[7 CFR 3560.656(b)(3)]*; and

- An Agency equity loan must be the last incentive option considered in developing an offer.

A. Rental Assistance

The Agency may offer rental assistance if the project tenants will experience rent overburden as a result of the incentive offer.

B. Increase in Annual Return

The Agency may offer an increase in the amount of the borrower's annual return on investment by one or both of the following methods:

- The Agency may recognize the borrower's current equity in the project at the original rate of return; and/or

- The Agency may increase the borrower's rate of return on the original equity.

The actual withdrawal of the return remains subject to conditions specified in 7 CFR 3560.301, and Chapter 4 of HB-2-3560.

C. Excess HUD Section 8 Rents

For projects with project-based HUD Section 8 assistance, the Agency may permit the borrower to receive rents paid to the project in excess of the amounts needed to meet annual project operating and maintenance expenses, debt service, and reserve requirements. This payment is received in a lump sum.

In these cases, the reserve account will be adjusted to provide adequate funding for long-term capital repairs and maintenance based on the project's capital plan.

D. Project Conversion or Modification of Interest Rate

The Agency may agree to convert full-profit loans to limited profit Plan II loans or increase the interest subsidy for loans with HUD Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

E. Agency Equity Loans

The Agency may make an equity loan to the borrower. The Agency may offer an equity loan only after it determines that all other incentive options will not result in an adequate incentive offer. The equity loan may not exceed the difference between the current unpaid loan balance and 90 percent of the project's value appraised as unsubsidized conventional housing.

The following requirements apply to equity loans:

- Labor housing projects are not eligible for equity loans;

- The loan must not adversely affect the borrower's repayment ability;

- Equity loans may be processed and closed with the current borrower or any eligible transferee; and

- If the equity loan is made in conjunction with excess HUD Section 8 funds, the equity will be paid using excess reserves before an equity loan is made.

F. Third-Party Equity Loans

A third-party equity loan is not considered an incentive, but it is an option the Agency may give the borrower at the same time it makes an incentive offer.

- All incentive requirements described in Paragraph 15.15 apply to third-party equity loans;

- An offer to allow the borrower to receive a third-party equity loan must be included in the incentive calculation worksheet located in Pre-Trac or by completing an Excel spreadsheet version for consideration in the Agency's incentive offer;

- In exchange for taking a third-party equity loan, the borrower must agree to the applicable 20-year use restrictions and all relevant requirements under this chapter;

- The third-party lender must take a subordinate lien position to the Agency;

- The third-party lender must agree in writing that foreclosure action under its lien will not be initiated before holding a discussion with the Loan Servicer and after giving a reasonable period of notice to the Agency; and

- A third-party equity loan may not be associated with a transfer of ownership.

15.17 DEVELOPMENT OF THE INCENTIVE OFFER

Loan Servicers will develop the incentive offer based on calculations outlined in Pre-Trac or using the electronic version in the form of an Excel spreadsheet. Loan Servicers should complete the worksheet, according to the directions in Pre-Trac (also provided in **Attachment 15-D** for the electronic version) and submit it to ORHP prior to making the offer to the borrower.

To help ensure the consistency of incentive offers, ORHP will review each completed worksheet and approve the proposed incentives before the offer is made to the borrower.

15.18 AGENCY OFFER OF INCENTIVES

Once ORHP approves the incentive package, the Loan Servicer must send a letter (located in Pre-Trac) to the borrower outlining the choice of incentives and informing the borrower that they must respond to the offer within 30 days.

15.19 BORROWER ACCEPTANCE OF INCENTIVES AND SUBSEQUENT ACTIONS *[7 CFR 3560.657]*

If a borrower accepts the Agency's offer of incentives, both the borrower and the Loan Servicer have a number of responsibilities.

A. Borrower Acceptance

If the borrower accepts the Agency's offer of incentives, the borrower must complete the following actions:

- The borrower must agree to restrictive-use provisions that prohibit prepayment for 20 years and adopt appropriate amendments to the project's loan documents and rental assistance agreements;

- If the incentive offer accepted includes an Agency equity loan, the borrower must complete an application for the equity loan and the borrower must remain eligible for it. For additional information on how to process the equity loan, see Chapter 10of HB-1-3560; and

- If the incentive offer accepted includes rent increases, the borrower must follow program requirements for rent increases. See Chapter 4 of HB-2-3560.

B. Closing the Incentive Offer

To close the incentive offer, the Loan Servicer must take the following steps:

- Prior to closing, notify ORHP via Pre-Trac that the borrower has accepted the incentive offer and to request the allocation of equity loan funds or Rental Assistance (RA) (as appropriate);

- ORHP will authorize all incentives and notify the State Office of the authorization;

- Insert appropriate restrictive-use provisions in the loan documents and rental assistance agreements (e.g., the deed, security instruments, loan agreement/resolution, assumption agreement, and/or reamortization agreement) with consultation from the Office of General Counsel (OGC):

  ◊ **For equity loans.** Execute a new loan agreement/resolution, *Form RD 3560-52, Promissory Note*, and mortgage and convert to Plan II if needed. Follow other loan closing procedures as described in Chapter 8 of HB-1-3560; and

  ◊ **For RA or increase in owner return.** Execute a new *Form RD 3560-9, Interest Credit and Rental Assistance Agreement*, with the borrower and change the loan agreement/loan resolution as necessary.

- Notify tenants and other interested parties that prepayment will not take place.

C. Transfers

If a transfer is to take place simultaneously with the Agency incentive offer, a complete transfer application package must be submitted as described in Chapter 7 of this handbook.

- If a proposed transferee is determined not to be eligible for the transfer and assumption, the borrower will be given an additional 45 days to reconsider whether to accept the original incentive offer or find another transferee; and

- In some cases, the Agency may make an offer of incentives contingent on the successful transfer of the project to an acceptable purchaser. The Agency may offer a smaller incentive if the transfer does not take place.

15.20 INSUFFICIENT FUNDING FOR INCENTIVES

In some cases, the borrower may be offered incentives that cannot be provided immediately. For example, the Agency may lack funding for equity loans or sufficient RA. If a borrower accepts an incentive offer but the Agency is unable to fund the incentive within 15 months, the borrower will be removed from the incentive waiting list. The borrower then has three options:

- The borrower may offer to sell the project to a nonprofit or public agency as described in Section 3 of this chapter;

- The borrower may stay on the list of borrowers awaiting incentives until the borrower's incentive offer is funded. If this option is chosen, the Agency will not renegotiate the incentive offer; and

- The borrower may withdraw the prepayment request and be removed from the list of borrowers awaiting incentives. If the borrower chooses this option, the borrower may submit a new request for prepayment and repeat the prepayment process.

15.21 BORROWER REJECTION OF INCENTIVE OFFER AND SUBSEQUENT ACTIONS *[7 CFR 3560.658]*

If the borrower rejects the incentive offer, the Loan Servicer must make a determination of the project's impact and whether it is needed, in accordance with Paragraph 15.22.

If the Agency determines that the project is not needed and that there is no adverse impact on minorities, the borrower may prepay without restrictions. After prepayment, the property leaves the program. Processing the prepayment is described in paragraph 15.22.

If the project is needed, or there is an adverse impact, the Loan Servicer must send the borrower a letter informing the borrower of four options:

- The borrower may prepay the Agency loan subject to use restrictions. The letter should describe the applicable use restrictions. Guidance on how to determine the appropriate use restriction is described in Paragraph 15.22.A.

- If the borrower does not want to accept the use restrictions, the borrower may offer the property for sale to nonprofit organizations and public agencies. This process is described in Section 3 of this chapter.

- The borrower may forgo prepayment and stay in the program.

- The borrower may appeal the decision to prepay with use restrictions. The borrower and Agency follow the appeal procedures described in Chapter 1.

The letter should also request the borrower to send a written response indicating the borrower's intentions within 30 days.

If the borrower chooses to prepay the loan subject to restrictive-use provisions, the Loan Servicer must determine the appropriate use restrictions to apply. The analysis for making this determination follows:

- **For prepayments that will have an adverse impact on minorities.** If the borrower chooses to prepay subject to use restrictions, the Agency must make a determination regarding the impact of the prepayment on minorities. Loan Servicing Staff should rely on Civil Rights Staff to make this determination. Relevant factors include:

  ◊ The percentage of minorities residing in the project and the percentage of minorities residing in projects in the market area where displaced tenants are most likely to move;

  ◊ The impact of prepayment on minority residents in the project and in the market area. Determine whether displaced minority tenants will be forced to move to other low-income housing in areas not convenient to their places of employment, to areas with a concentrated minority population, and/or to areas with a concentration of substandard housing;

  ◊ The vacancy trends and number of potential minority tenants on the waiting list at the project being prepaid and at other projects in the market that might attract minority tenants; and

  ◊ The impact prepayment will have on the opportunity for minorities residing in substandard housing in the market area to have comparable decent, safe, and affordable housing, as is offered by the project being prepaid.

If Civil Rights Staff determine that the prepayment will have a negative impact on minorities, the borrower must adopt use restrictions that protect the affordability of the project over the long term.

- **For prepayments that will have an adverse impact on the adequacy of supply of affordable housing.** In projects where the prepayment does not have an adverse impact on minorities, the borrower is required to adopt use restrictions that protect the access of current tenants to adequate affordable housing. These provisions prohibit the borrower from raising rents for tenants who live in the property at the time of prepayment unless the rent increase is necessary to meet the operating costs of the project. (Their rents cannot be raised as a result of actions associated with prepayment.)

15.22 DETERMINATION OF PREPAYMENT IMPACT

One of the Agency's key goals in the prepayment process is to ensure that affordable housing opportunities exist for program eligible tenants. Therefore, one of the most important issues to address is the impact of the prepayment on project tenants. In cases where prepayment will have little or no impact on project rents or availability of units, the Agency has less interest in keeping the property in the program than in cases where prepayment will likely result in the displacement of project tenants.

To make this determination, the Loan Servicer will review the following information provided in the market study:

- Existence of comparable conventional units, their rents, and vacancy rates;
- Any plans to build a similar project in the market area; and
- Other subsidized units and the availability of rental assistance.

The goal of this analysis is to determine if tenants will lose their units or suffer from rent overburden. The steps involved in the analysis of impact depend on whether the project has rental assistance.

A. Prepayment Impact on Projects without Rental Assistance

For these projects, the Loan Servicer must review the prepayment request, including market information, and address the following items:

- **Change in rents or loss of units.** The Loan Servicer must look at the impact of the prepayment on tenants' ability to stay in the project. This analysis depends on the proposed use of the project after prepayment and rents for comparable conventional units in the market area. (For example, if the proposed use of the project is conventional rental units, the Loan Servicer should compare rents in the project to conventional rents in the market area.) Likely rents should be compared to tenants' income to ensure that a change in rents will not result in rent overburden.

  ◊ If the prepayment is not likely to result in an increase in rents above current rents or 30 percent of tenants' adjusted incomes, the prepayment is considered to have no adverse impact on project tenants; and

◊ If the prepayment is likely to result in an increase in rents that will create rent overburden, the Loan Servicer must consider the availability of alternative comparable housing as described below.

- **Availability of alternative housing.** If the proposed use of the project after prepayment is likely to cause an increase in rents or a loss of units, the Loan Servicer must assess the availability of comparable housing in the community. The Loan Servicer must determine if there is sufficient housing that is comparable in size and rent to house project tenants in the local community without causing them rent overburden.

  ◊ If there is sufficient comparable housing in the local community to replace the units that will be lost after prepayment, then the prepayment is considered to have no adverse impact on project tenants; and

  ◊ If sufficient comparable housing is not available in the local community, the prepayment is considered to have an adverse impact on project tenants.

B. Prepayment Impact on Projects with Rental Assistance

If project tenants have rental assistance, the Loan Servicer must conduct the same analysis as described in Paragraph 15.22(A). However, in assessing the availability of comparable affordable units, the Loan Servicer must identify comparable units with rental assistance or other rental subsidy such as HUD Section 8 (as long as the tenants will have priority for these units).

- If sufficient comparable units with rental assistance are available in the local community to house all tenants with rental assistance (for example, if another Section 515 project in the local community has vacancies to house the tenants from this prepaid property), the prepayment is considered to have no adverse impact.

- If insufficient units with rental assistance are available, the prepayment is considered to have an adverse impact on project tenants.

  Exhibit 15-3 of this section provides an overview of the full analysis of impact.

Exhibit 15-3

Analysis of Impact on Tenants

Step 1: Answer the following questions about rents and loss of units.

A. Will prepayment result in an increase in tenant payments and if so, will this new payment be higher than 30 percent of the current tenants' incomes?

OR

B. Will prepayment result in a loss of units?

If the answer to both A and B is no, there is no adverse impact on tenants.
If the answer to either A or B is yes, proceed to step 2.

Step 2: Answer the following questions about the availability of alternative housing:

A. Are there sufficient comparable vacant units in the market area (as indicated by the market study) for displaced tenants to find alternative housing?

AND

B. Are the tenant payments in these units equal to or less than the greater of their current rent of 30 percent of their income?

If the answer to both C and D is yes, there is no adverse impact on tenants.
If the answer to either C or D is no, there is an adverse impact on tenants.

C. Processing the Prepayment

Prior to prepayment, the Loan Servicer must take the following steps:

- Establish the target date for the prepayment to occur;
- Prepare the prepayment figures based on the borrower's outstanding balance on the Agency loan; and
- Notify tenants and other interested parties of the prepayment and its implications. Tenants must be notified at least 60 days in advance of the prepayment date.

To finalize the prepayment, the Loan Servicer must:

- Document the borrower's satisfaction of the mortgage; and
- Place a deed restriction on the property to establish the use restrictions.

D. Monitoring Compliance with the Use Restrictions

If a borrower prepays a loan and the project remains subject to continued restrictive-use provisions, the following requirements apply after prepayment:

- The owner of the prepaid project (formerly the borrower) is responsible for ensuring that the restrictive-use provisions agreed to as a condition of prepayment are observed and must retain appropriate documentation to demonstrate compliance with the use restrictions;

- The owners must provide the Agency with a signed and dated certification within 30 days of the beginning of each calendar year for the full period of the restrictive-use provisions establishing that these provisions are being met;

- The Loan Servicer must visit the site on an annual basis to perform an annual physical inspection;

- The Loan Servicer must also investigate any complaints from tenants or other parties regarding the violation of the use restrictions; and

- The Loan Servicer must keep owner certifications and records of visits in the project file.

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SECTION 3: LOANS CLOSED BETWEEN 1979 AND 1989 WITH A RESTRICTIVE AGREEMENT

15.23 APPLICABILITY

For borrowers whose loans have restrictive agreements and which closed between 1979 and 1989, Loan Servicers should follow the procedures in this section. For loans closed between 1979 and 1989 with no restrictive agreements, follow the procedures in Section 2 of this chapter.

15.24 REQUEST BORROWER TO REMAIN IN PROGRAM

The Agency will make an effort to enter into a restrictive-use agreement with borrowers who received Section 514 or 515 loans on which restrictive-use provisions are still in place, who received "restricted" loans, or who make a prepayment request and prepayment is feasible. If a borrower accepts the Agency's request to enter into a 20-year restrictive-use agreement, without prepayment, no further action is necessary.

If a borrower declines the Agency's offer, the Loan Servicer should document this in writing, noting the date on which this information was obtained. The document should be included in the case file. The Loan Servicer should then proceed to review the prepayment process to determine the impact of prepayment.

15.25 SALE TO A NONPROFIT OR PUBLIC BODY *[7 CFR 3560.659]*

A borrower who rejects the Agency's offer to enter into a restrictive-use agreement may offer the project for sale to nonprofit or public agencies. A borrower who is being processed under Section 2 of this chapter, where the Agency's incentive offer is rejected may offer the project for sale to nonprofit or public agencies. A borrower who accepts the incentives but does not receive them within 15 months of accepting them, may offer the project for sale to nonprofit and public agencies. This process can take up to 30 months to complete. At the end of this process, if the property has not been purchased, the borrower is permitted to prepay without restrictive-use provisions.

The sale process has several steps:

- The property must be marketed for 180 days as described in Paragraph 15.27;
- If no offer is made within 180 days, the borrower may prepay the loan without use restrictions (see Paragraph 15.31);
- Offers received within the 180 days must be treated as described in Paragraph 15.28;
- If an offer is accepted, the purchaser must finalize the sale within 24 months. If the sale is not finalized, the borrower may prepay the loan without use restrictions (see Paragraph 15.31); and

- After a sale is completed, the Loan Servicer must oversee the transfer of the property and continue to monitor the project as a program property (see Paragraph 15.30).

15.26 ESTABLISHING THE PROJECT VALUE

To establish the value of the property (as an unsubsidized conventional property) and determine an acceptable offer, two independent "as-is" market value appraisals will be completed in accordance with Chapter 7 of HB-1-3560. The borrower must pay the expense of the borrower's appraisal. The appraiser selected may not have an identity-of-interest with the borrower.

If the two appraisers fail to agree on the fair market value, the Agency and the borrower will jointly select an appraiser whose appraisal will be binding. The Agency and the borrower will jointly fund the cost of the appraisal.

15.27 MARKETING REQUIREMENTS

The Loan Servicer must ensure that the borrower takes appropriate actions to inform appropriate entities of the sale. The borrower must provide the Loan Servicer with appropriate documentation (e.g., copies of advertisements) to demonstrate that the following actions occurred:

- The borrower must contact interested nonprofit organizations and public agencies from the list maintained by ORHP. The borrower should also contact other interested organizations.

- The borrower must provide these entities with sufficient information regarding the project and its operations for interested purchasers to make an informed decision. This information must include the minimum acceptable bid prices based on the appraised market value (as discussed in Paragraph 15.26). It should also state the preference for local entities, as described in Paragraph 15.28.

- If an interested purchaser requests additional information concerning the project, the borrower must promptly provide the requested materials.

- The borrower must advertise and offer to sell the project for a minimum of 180 days. The borrower may choose to suspend advertising and other sales efforts while eligibility of an interested purchaser is determined. If the purchaser is determined to be ineligible, the borrower must resume advertising for the balance of the required 180 days.

15.28 SELECTING AN OFFER

The borrower must accept any bona fide offer at or above the minimum acceptable bid price.

- **Requirements for nonprofit organizations and public agencies to purchase.** To buy and operate a multi-family housing project, a nonprofit organization or public agency must meet the requirements listed in Exhibit 15-4.

Exhibit 15-4

Requirements for Nonprofit Organizations and Public Agencies to Purchase

- The purchaser must agree to maintain the housing for very low- and low-income families or persons for the remaining useful life of the project and related facilities. However, currently eligible moderate-income tenants will not be required to move;
- The purchaser must agree that no subsequent transfer of the housing and related facilities will be permitted for the remaining useful life of the housing and related facilities unless the Agency determines that the transfer will further the provision of housing and related facilities for low-income families and persons, or there is no longer a need for such housing and related facilities;
- The purchaser must show financial feasibility of the project including anticipated funding;
- The purchaser must certify on *Form RD 3560-30* that there are no identity-of-interest relationships;
- The purchaser must complete an Agency-approved application and obtain Agency approval in accordance with 7 CFR part 3560 subpart I; and
- To be eligible to purchase properties, nonprofit organizations must meet the criteria outlined in 7 CFR part 3650, subpart B. These requirements are discussed in Chapter 4 of HB-1-3560.

- **Preference for local nonprofit and public agencies.** Local nonprofit organizations and public agencies have priority over regional and national nonprofit and public agencies. The borrower may not accept an offer from a regional or national nonprofit organization or public agency during the first 60 days that the property is advertised.

  ◊ If no offer from a local nonprofit or public agency is received in the first 60 days, the borrower may accept an offer from a regional or national nonprofit organization or public agency.

  ◊ If more than one qualified nonprofit organization or public agency submits an offer to purchase the project, the Agency will give priority to qualified local nonprofit organizations and public agencies over regional and national nonprofit organizations and public agencies.

  ◊ If additional criteria are needed to make a selection, the borrower must consider the organization's past success in developing and maintaining subsidized housing and the length of experience in developing and maintaining subsidized housing.

Past success is given priority over length of experience when comparing equal offers.

- **Approving an offer.** The Loan Servicer must approve the borrower's acceptance or rejection of any offer for purchase. If the borrower receives an offer, they must notify the Loan Servicer of the offer and whether or not they want to accept the offer. The Loan Servicer must review the borrower's decision.

  ◊ If the borrower wants to reject the offer, the Loan Servicer must concur with the borrower's reasons for rejection. If the Loan Servicer does not concur, the borrower must accept the offer.

  ◊ If the offer is to be accepted, the proposed purchaser must submit appropriate documentation to the Agency to demonstrate eligibility for the transfer. The Loan Servicer must approve the transfer and then take appropriate steps to close the transfer (see Chapter 7 for the procedures for transfer).

15.29 LOANS MADE BY THE AGENCY OR OTHER SOURCES TO NONPROFIT ORGANIZATIONS AND PUBLIC AGENCIES

The Agency may make loans to nonprofit organizations or public agencies to facilitate the purchase of the project. Alternatively, the Agency may approve a loan from another entity. These loans must be approved as described in HB-1-3560. They may be made for either of the purposes described below.

- A loan may be made to enable the nonprofit organization or public agency to purchase a project at the appraised value; and

- With proper justification, a loan may be made to help meet the project's first-year operating expense if current operating funds are not sufficient. This loan may not exceed two percent of the project's appraised value.

The Agency may also make an advance of up to $20,000 to a nonprofit organization or public agency to cover the costs to develop a loan application package or close a loan to purchase a property.

15.30 POSTSALE REQUIREMENTS

Once the property has been sold to a nonprofit or public agency, the new owner of the property is subject to all applicable program requirements and use restrictions that applied to the property prior to the sale.

- The Loan Servicer must ensure that the transfer of the property takes place according to Agency rules and that the new owner is made subject to all applicable use restrictions (see Chapter 7);

- The Loan Servicer must notify tenants and other interested parties that the sale will take place; and

- The Loan Servicer will monitor this property as it monitors all other program properties (see Chapter 9 of HB-2-3560).

15.31 REQUIREMENTS FOR BORROWERS IF AN ACCEPTABLE PURCHASER IS NOT FOUND

If no purchaser is found for the property within the 180-day marketing period or if an offer is made but the purchaser fails to come up with the funds to complete the purchase within 24 months, the borrower is considered to have fulfilled the requirements for offering the property for sale. At this time, the borrower is permitted to prepay the Agency loan without use restrictions.

The Loan Servicer must:

- Send a letter to the borrower notifying him or her that prepayment is permitted; and

- Close out the application in Pre-Trac.

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SECTION 4: SPECIAL CIRCUMSTANCES

15.32 PROPERTIES UNDER BANKRUPTCY OR FORECLOSURE

Bankruptcy proceedings will have no effect on contractual requirements for restrictive use.

If a project that is subject to restrictive-use provisions is sold outside the program at a foreclosure sale, the Agency has no means to continue to enforce restrictive-use provisions after the purchase.

15.33 ADVANCE PAYMENT OF ACCOUNTS

When an Agency loan, which is not subject to prepayment prohibitions, reaches or falls below six remaining payments due to a borrower's voluntary advance payments or extra payments required by the Agency, the borrower will be notified that the final payment on the account cannot be accepted unless a prepayment request is made. The borrower will be required to submit all applicable information to a prepayment request.

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ATTACHMENT 15-A

OVERVIEW OF PREPAYMENT PROCESS

Outlined below is a summary of the conditions to be met for making key decisions related to the prepayment process.

What are the criteria for accepting a prepayment request?

- The borrowers' loans were closed before 1989;
- All items on the application checklist have been submitted; and
- The borrowers submit proof of their ability to prepay their loans.

You may issue a general or specific incentive offer to a borrower if the following conditions are met:

- The application has been accepted (see criteria listed above);
- The existing loan is a Rural Rental Housing (RRH) loan or an Off-Farm Labor Housing loan;
- The loan closed prior to 1979; and
- There are no restrictive-use provisions associated with the loan.

Note: If the borrower is inclined not to accept a specific incentive offer, you may proffer a general offer and proceed from there when the borrower declines the offer. If, however, the borrower accepts the general offer, you must then proceed with a specific incentive offer.

A borrower may prepay WITHOUT use restrictions when the following conditions are met:

- If the borrower rejects the general and/or specific incentive offers and the property is not needed;
- If the borrower appeals the decision to prepay with use restrictions, when the property is needed, and wins the appeal;
- If the borrower markets the property to a nonprofit organization and a buyer is not found within 180 days; and
- If the borrower markets the property and a buyer is found, but the deal fails to close.

A borrower may prepay WITH use restrictions when the following conditions are met:

- If the borrower rejects the general or specific incentive offer and the property is needed.

A borrower can market the property to a nonprofit organization under the following circumstances:

- If the borrower's loan closed between 1979 and 1989 and the borrower does not wish to continue in the program, but agrees to sell the property to a nonprofit organization;

- If the borrower's loan closed between 1979 and 1989 and the borrower does not wish to continue in the program or sell to a nonprofit organization. However, a subsequent needs assessment reveals that minority tenants will be materially affected. In this case, the borrower is obligated to sell to a nonprofit organization;

- If a pre-1979 borrower declines both the general and specific incentive offers. A needs assessment reveals that the property is needed. The borrowers can then agree to sell to a nonprofit organization if he or she does not wish to prepay with use restrictions; and

- If a pre-1979 borrower declines both the general and specific incentive offers, but a needs assessment reveals that the property is needed. The borrowers can then appeal the decision. However, if they lose the appeal, they can then agree to sell to a nonprofit organization if they do not wish to prepay with use restrictions.

A request is returned to the borrower under the following circumstances:

- If the borrower's loan closed after 1989;

- If the borrower's prepayment request is withdrawn or rejected; and

- If the project is needed, the borrower is obligated to prepay with use restrictions. The borrower can then appeal. It the borrower loses the appeal, he or she may decide to withdraw the application rather than have to sell to a nonprofit organization.

ATTACHMENT 15-B

EXPLANATION OF INCENTIVE OFFERS

(1) The Agency may increase the borrower's annual return on equity by one of the following two methods. The actual withdrawal of the return remains subject to the procedures and conditions for withdrawal specified in 7 CFR part 3560 subpart G of this part.

(2) The Agency may recognize the borrower's current equity in the housing project. The equity will be determined using an Agency accepted appraisal based on the housing project's MARKET value.

(3) When a current appraisal indicates an equity loan can not be made, the Agency may recognize the borrower's current equity in the housing project at the higher of the original rate of return or the current 15-year Treasury bond rate plus 2 percent rounded to the nearest one-quarter percent. The equity will be determined using the most recent Agency accepted appraisal of the housing project prior to receiving the prepayment request.

(4) The Agency may agree to convert projects without interest credit or with Plan I interest credit to Plan II interest credit or increase the interest credit subsidy for loans with HUD Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

(5) The Agency may offer additional rental assistance, or an increase in assistance provided under existing contracts under §§ 521(a)(2), 521(a)(5) of the Housing Act of 1949 [42 U.S.C. 1490a (a)(2)] or section 8 of the United States Housing Act of 1937 [42 U.S.C. § 1437f].

(6) The Agency may make an equity loan to the borrower. The equity loan must not adversely affect the borrower's ability to repay other Agency loans held by the borrower and must be made in conformance with the following requirements:

(7) The equity loan must not exceed the difference between the current unpaid loan balance and 90 percent of the housing project's value as determined by an "as-is" market value appraisal conducted in accordance with 7 CFR part 3560 subpart P of this part.

1. Borrowers with farm labor housing loans are not eligible to receive equity loans as incentives.

2. If an incentive offer for an equity loan is accepted, the equity loan may be processed and closed with the borrower or any eligible transferee.

3. Excess reserve funds will be used to reduce the amount of an equity loan offered to a borrower.

4. Equity loans may not be offered unless the Agency determines that other incentives are not adequate to provide a fair return on the investment of the

borrower to prevent prepayment of the loan or to prevent displacement of project tenants.

(8) The Agency will offer rental assistance to protect tenants from rent overburden caused by any rent increase as a result of a borrower's acceptance of an incentive offer or tenants who are currently overburdened.

All incentives will be processed using the Incentive Calculation Worksheet. The Worksheet has two versions:

- A Stand Alone Excel Spreadsheet located on the Agency's Intranet; or
- The Pre-Trac version.

ATTACHMENT 15-C

SAMPLE LETTERS TO TENANTS

Initial Tenant Notification of Owner's Intent to Prepay

TO: The Tenants of Riddlebrook Apts

SUBJECT: Notice of Prepayment Request

Your apartment was developed with a loan from the U.S. Department of Agriculture (USDA) Rural Development, an Agency of the U.S. Government. The owners of your apartment recently asked USDA for permission to pay off their USDA loan ahead of schedule.

Based on USDA's communications with the owner so far, it is not clear whether:

* The owner plans to continue to operate the apartments as affordable rental housing, or to sell or operate the apartment as conventional, market rate apartments.

* The owner wants to prepay their USDA loan, and then either sell or operate the apartment as conventional, market rate apartments.

* The owner wants to sell the property to a new owner who is willing to continue to operate the apartments as affordable rental housing.

* The owner does not really plan to prepay their USDA loan. The owner has applied in order to qualify for financial incentives from USDA. In return for the incentives, the owner must continue to operate the apartments as affordable rental housing.

In any case, if USDA agrees to the owner's request and if the owner actually does pay off the USDA loan, rents at the apartments could go up and USDA would not be able to provide rent subsidy for tenants. Also USDA would no longer be involved in supervising the apartment's management, leases and rents.

USDA WOULD LIKE TO KNOW YOUR OPINION ABOUT THIS PAYOFF REQUEST. We would like to know what you think the effect of paying off the loan would be on you, other tenants in the apartments, other people in the community, and any minorities living in the apartments and in the community. You have 30 days from the date of this letter to give us your opinion in writing. If you wish to write us, please send your comments to the local USDA Office at the address shown above.

It may be helpful to know that USDA follows a very careful process before deciding whether or not to allow apartment owners to pay off their USDA loans. First, USDA may offer various financial incentives to the owners to encourage them not to prepay their loan and to continue to operate the apartments for affordable rental housing. Often such incentives are sufficient to

prevent prepayment, and the apartment will continue to be operated without change for the tenants.

However, if the owner is not interested in the financial incentives that USDA can offer, USDA will evaluate how prepayment would affect the tenants of the apartments.

* If USDA decides that housing opportunities for minorities would be materially affected by a prepayment, USDA will require that the owner try to sell the apartments to a nonprofit organization or public agency which would continue to operate the apartments for affordable rental housing.

* If USDA decides that there is an inadequate supply of affordable rental housing nearby, USDA may require that the owner continues to provide low rents to you and the other current renters, even if rents go up for future tenants.

* If USDA decides to allow the owner to prepay, you and the other tenants may be given immediate priority for other USDA financed apartments. Even if USDA's loan is paid off, the owner will not be able to evict any tenant without cause.

We will keep you notified of the status of this request until a final resolution is reached. You will be allowed to review the information used by USDA to make its decisions regarding prepayment.

If the owner disagrees with the decision that USDA makes on the prepayment request, the owner may be given an opportunity to appeal USDA's decision. If the owner appeals, tenants will be given the opportunity to submit evidence at the appeal hearing.

Please contact our office if you have any questions or concerns.

Sincerely,

Notification of Sale to a Nonprofit Organization or Public Body

[Insert Tenant Address]

TO: Tenants of [Project Name]

Rural Development has reviewed relevant information concerning a request from your landlord (Insert Owner's Name) to pay off the Rural Development loan on (Enter Name of Project). Rural Development has decided that we cannot accept the payoff because we determined that tenants would be adversely affected by a prepayment. Therefore, Rural Development has offered the owner an incentive to stay in program and not prepay the loan.

Rural Development is considering providing a loan to **[Insert name of new nonprofit or public body]**, a nonprofit organization/public housing authority, to finance the owner's equity in the property and to purchase the property in exchange for an extension of the low- and moderate-income use of the housing. **[Insert name of new entity]** would be required to continue to use the property for the purpose of housing very low- and low-income people eligible for occupancy as provided in Rural Development regulations during the remaining useful life of the project. You may remain in the project throughout the remaining useful life of the project, and as long as you remain eligible or wish to occupy your apartment/unit. Rents, other charges, and conditions of occupancy will be set to meet these conditions. **[Insert name of new entity]** would only be released from these obligations when the government determines that (1) there is no longer a need for such housing; (2) that such other financial assistance provided to the residents of such housing will no longer be provided due to no fault, action, or lack of action on the part of **[insert name of new entity]**. The restrictions are intended to protect only very low- and low-income individuals and families for the remaining useful life of the project. These restrictions will not be superceded by new restrictions imposed by any subsequent transfers of the property. Eligible moderate-income tenants living at the project at the time of prepayment will not be required to move as a result of the restrictions.

Information regarding the approval of the prepayment can be reviewed at the Rural Development Area Office located at **[Insert address]**. Please call ahead to arrange an appointment if you wish to review this information.

If you have any questions, please contact me prior to **[enter date].**

Sincerely,

Rural Development Specialist

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ATTACHMENT 15-D

INCENTIVE CALCULATION WORKSHEET AND DIRECTIONS

State Office:					Contact Person:		
Project Name:					Project Location:		
Borrower Name:					Borrower I.D.:		
Date Submitted to ORHP:					Project Number:		
Number of Units:		Current Basic Rents:		Comparable Rents:		Other Data:	
	: 0 Bedroom		: 0 Bedroom		: 0 Bedroom		: Original Debt
	: 1 Bedroom		: 1 Bedroom		: 1 Bedroom		: Current Debt
	: 2 Bedroom		: 2 Bedroom		: 2 Bedroom		: Initial Bor. contribution
	: 3 Bedroom		: 3 Bedroom		: 3 Bedroom		: Original ROI rate
	: Other Br.		: Other Br.		: Other Br.		: 30 yr. Tres. Bond rate
0	Total	#DIV/0!	Average	#DIV/0!	Average		: Authorized reserve balance
	: Appraised value prior to prepayment						: Current reserve balance
	: Appraised value as unsubsidized conventional housing						: Required capital needs
	: Interest rate of third party equity loan						: Add'l monthly reserve deposit per unit
	: Term of third party equity loan						: Current Debt Service
	: Term of reamortized RHS debt					#DIV/0!	Reamortized Debt Service
	: Term of Agency equity loan						Will you ream the debt? Enter yes or no.
1%	Interest rate for Agency equity loan/reamortization						

MAXIMUM RHS EQUITY LOAN		MAXIMUM THIRD-PARTY EQUITY LOAN	
$ -	Appraised value (unsub. conv. housing)	#DIV/0!	Max. equity loan after using excess reserves for equity
-	Maximum equity (90%)	#DIV/0!	New debt service for third party equity loan
$ -	(Current debt)	#DIV/0!	Debt Service for existing RHS loan
$ -	90% RHS equity	#DIV/0!	New total debt service
$ -	Total excess reserve	#DIV/0!	Difference between new and current debt service
$ -	90% eq. loan, less excess res. for eq., w/o regard to comp. rent	#DIV/0!	Monthly/per unit increase to debt service
#DIV/0!	Max. eq. loan w/i comp. rents, less ex. res. for eq.	#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)	#DIV/0!	Average current rent
#DIV/0!	New basic rent after RHS equity loan	#DIV/0!	Average rent with new debt service
#DIV/0!	Amount above or (below) comparable rent	#DIV/0!	Plus any additional reserve requirement
MAXIMUM RHS EQUITY LOAN AND INCREASED ROI		#DIV/0!	Average comparable rent
#DIV/0!	Max. eq'ty loan after using ex. res. for eq'ty	#DIV/0!	Amount above or (below) comparable rent
#DIV/0!	New debt service (DS) for equity loan	**INCREASED ROI WHEN AN EQUITY LOAN CANNOT BE OFFERED**	
#DIV/0!	Debt service for existing RHS loan	$ -	Appraised value prior to prepayment
#DIV/0!	New total debt service	$ -	(Current balance)
#DIV/0!	Difference between new and current DS	$ -	Current equity position
#DIV/0!	Monthly/per unit increase to DS	$ -	ROI w/o equity loan at 8%
#DIV/0!	New equity position	$ -	ROI w/o equity loan at Treasury rate +2
#DIV/0!	New ROI	$ -	Original ROI
$ -	Original ROI	$ -	TOTAL INCENTIVE: NEW ROI
#DIV/0!	Difference betw'n new and current ROI	$ -	Difference betw'n new and current ROI
#DIV/0!	Monthly/per unit increase to ROI	#DIV/0!	Monthly/per unit increase to ROI
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + INCR. ROI + EX. RES.)	#DIV/0!	Average current rent
#DIV/0!	Average current rent	#DIV/0!	Average rent with new ROI
#DIV/0!	Average rent with new ROI and DS	#DIV/0!	Plus any additional reserve requirement
#DIV/0!	Plus any additional reserve requirement	#DIV/0!	Average comparable rent
#DIV/0!	Average comparable rent	#DIV/0!	Amount above or (below) comparable rent
#DIV/0!	Amount above or (below) comparable rent	**RHS EQUITY LOANS IN CONJUNCTION WITH TRANSFERS AND SALES**	
INCREASED ROI WHEN AN EQUITY LOAN COULD BE OFFERED, BUT IS NOT		#DIV/0!	Max. eq. loan in transfer to ltd. Profit with tax credits (<=95%), less ex. res.
$ -	RHS Debt Service	#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
$ -	Decrease in current monthly debt service, if any	#DIV/0!	New basic rent after equity loan
#DIV/0!	Monthly per-unit decrease to debt service, if any	#DIV/0!	Amount (below) comparable rent
$ -	Appraised value (unsub. conv. housing)	#DIV/0!	Max. eq. loan in transfer to ltd. Profit, no tax credits (<=97%), less ex. res.
$ -	(Current debt)	#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
$ -	Max. new equity position with ROI only	#DIV/0!	New basic rent after equity loan
$ -	TOTAL INCENTIVE: NEW ROI	#DIV/0!	Amount (below) comparable rent
$ -	Original ROI	#DIV/0!	Max. eq. loan in transfer or sale to nonprofit (<=100%), less ex. res.
$ -	ROI increase with new equity position	#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	Monthly/per unit increase to ROI	#DIV/0!	New basic rent after equity loan
#DIV/0!	Average current rent	#DIV/0!	Amount above or (below) comparable rent
#DIV/0!	Average rent with new ROI and DS	COMMENTS:	
#DIV/0!	Plus any additional reserve requirement		
#DIV/0!	Average comparable rent		
#DIV/0!	Amount above or (below) comparable rent		

INSTRUCTIONS FOR RHS INCENTIVE CALCULATION WORKSHEET

1. **GO TO PROJECT LIST SCREEN**

2. **CLICK ON QUERY**

3. **TYPE IN "OR"**

4. **CLICK ON QUERY AGAIN - this will give you a listing of every application in the State of Oregon.**

5. **ONCE YOU HAVE THE PROJECT NAME AND BORROWER NAME FROM THE PROJECT LISTING - CLICK ON SCREENS; THEN CLICK ON "BORROWER"**

6. **WHEN YOU GET TO THE BORROWER SCREEN, CLICK ON QUERY, TYPE IN OR IN THE STATE FIELD, CLICK ON QUERY AGAIN.**

7. **THE FIRST BORROWER WILL APPEAR FOR THE STATE OF OREGON**

8. **CLICK ON THE "DOWN" BUTTON UNTIL YOU SEE THE BORROWER YOU ARE LOOKING FOR.**

9. **PRINT THAT PAGE; THEN CLICK ON THE GREEN RECTANGULAR BUTTON THAT SAYS "PROJECT" AND PRINT THAT SCREEN**

10. **THEN CLICK ON THE "NEXT" BUTTON (NOTE: You'll see a dialogue box that asks if you want to continue working with this borrower/application) CLICK YES**

11. **THIS WILL TAKE YOU BACK TO THE PROJECT LIST; CLICK ON TIMELINE FOR THAT APPLICATION**

12. **CLICK ON THE GREEN BUTTON THAT SAYS "TIMELINE TREE"**

13. **CLICK ON "TIMELINE TREE"**

14. **CLICK ON "TIMELINE RPT"**

15. **THE TIMELINE REPORT WILL APPEAR IN A SEPARATE ACROBAT WINDOW; CLICK ON THE "PRINTER" ICON**

16. **ONCE THE REPORT HAS PRINTED, CLOSE THE ACROBAT WINDOW.**

17. **CLICK ON "TIMELINE" AND ONCE BACK TO THE TIMELINE SCREEN CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Application Checklist Screen)**

18. PRINT PAGE 1 OF THE CHECKLIST SCREEN

19. CLICK ON THE GREEN RECTANGULAR "PROJECT NEEDED" BUTTON

20. PRINT PAGE 2 OF THE CHECKLIST SCREEN

21. CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Prepayment Information Screen)

22. PRINT PAGE 1 OF THE PREPAYMENT INFORMATION SCREEN

23. CLICK ON THE GREEN RECTANGULAR "PREPAY, PAGE 2" BUTTON

24. PRINT PAGE 2 OF THE PREPAYMENT INFORMATION SCREEN

25. CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Incentive Calculation Worksheet)

26. PRINT ALL 11 PAGES OF THE INCENTIVE CALCULATION WORKSHEET

THAT'S IT.

PLEASE PRINT THE SCREEN EVEN IF IT IS BLANK.

NOTE: CHECK THE TIMELINE SCREEN TO SEE IF ANY OF THE PROJECTS HAVE REHAB/REPAIR/DEFERRED MAINTENANCE; IF SO, PRINT THOSE 2 SCREENS AS WELL.

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ATTACHMENT 15-E

RESTRICTIVE-USE PROVISIONS AND AGREEMENTS

(a) The undersigned, and any successors in interest, agree to use the subject property (described herein) in compliance with 42 USC 1484 or 1485, whichever is applicable, and applicable regulations and the subsequent amendments, for the purpose of housing:

(1) very low, or low income households when required by 7 CFR 3560.658 (a)(3) or (b)(1), or

(2) very low, low, or moderate income households when required by 7 CFR 3560.655, 3560.658 (a)(1) and (2) and (b)(2), or 7 CFR 3560.401.

(b) The period of the restriction will be inserted in accordance with the following:

(1) 10 years if required by 7 CFR 3560.658 (a) (1);

(2) 15 years if required by 7 CFR 3560.655;

(3) 20 years if required by 7 CFR 3560.655 or 3560.656;

(4) 30 years if required by 7 CFR 3560.406(g);

(5) Remaining period of existing Restrictive Use Provision's if required by 7 CFR 3560.655 or 3560.658 (a)(2);

(6) The remaining useful life of the housing and related facilities if required by 7 CFR 3560.658 (a)(3) and (b)(1);

(7) The last existing tenant (that occupied the property on the date of prepayment) voluntarily vacates if required by this subpart.

(c) When required by 7 CFR 3560.658 (a)(1) and (2), the borrower will also agree that at the expiration of this restriction, the undersigned agrees to offer the property for sale to a qualified nonprofit organization or public body, in accordance with previously cited statutes and regulations.

(d) The Agency and eligible tenants or applicants may enforce these restrictions.

(e) The borrower must also agree to the following requirements to implement these restrictions:

(1) rents, other charges, and conditions of occupancy will be set to meet these conditions;

(2) an Agency approved notice of this restriction will be posted for tenants of the project;

(3) to adhere to applicable local, state, and Federal laws; and

(4) to obtain Agency concurrence for any rental procedures that deviate from those approved at the time of prepayment, prior to implementation.

(f) The borrower will be released from these obligations before that date only when the Agency determines that there is no longer a need for the housing or that such other financial assistance provided the residents of the housing will no longer be provided due to no fault, action or lack of action on the part of the borrower.

APPENDIX 1

TEXT OF 7 CFR PART 3560

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APPENDIX 2

TEXT OF 7 CFR PART 11

designee, if the fund-raising program is multi-State or Nationwide.

(b) When used to promote 4–H educational programs, the 4–H Club name and emblem, subject to obtaining authorization as provided in these regulations, may be used on or associated with products and services sold in connection with 4–H fund-raising programs so long as no endorsement or the appearance of an endorsement of a commercial firm, product or service is either intended or effected. Tributes to 4–H contained on or associated with commerical products or services, when such products or services are used for the fund-raising activities, are subject to the requirements of this paragraph. All moneys received from 4–H fund-raising programs, except those necessary to pay reasonable expenses, must be expended to further the 4–H educational programs.

[52 FR 8432, Mar. 17, 1987, as amended at 60 FR 52293, Oct. 6, 1995]

PARTS 9–10 [RESERVED]

PART 11—NATIONAL APPEALS DIVISION

Subpart A—National Appeals Divison Rules of Procedures

Sec.

Subpart B—Organization And Functions

Subpart C—Availability of Information to the Public

Subpart A—National Appeals Divison Rules of Procedures

AUTHORITY: 5 U.S.C. 301; Title II, Subtitle H, Pub. L. 103–354, 108 Stat. 3228 (7 U.S.C. 6991 *et seq.*); Reorganization Plan No. 2 of 1953 (5 U.S.C. App.).

SOURCE: 64 FR 33373, June 23, 1999, unless otherwise noted.

§ 11.1 Definitions.

For purposes of this part:

Adverse decision means an administrative decision made by an officer, employee, or committee of an agency that is adverse to a participant. The term includes a denial of equitable relief by an agency or the failure of an agency to issue a decision or otherwise act on the request or right of the participant within timeframes specified by agency program statutes or regulations or within a reasonable time if timeframes are not specified in such statutes or regulations. The term does not include a decision over which the Board of Contract Appeals has jurisdiction.

Agency means:

(1) The Commodity Credit Corporation (CCC);

(2) The Farm Service Agency (FSA);

(3) The Federal Crop Insurance Corporation (FCIC);

(4) The Natural Resources Conservation Service (NRCS);

(5) The Risk Management Agency (RMA);

(6) The Rural Business-Cooperative Service (RBS);

(7) Rural Development (RD);

(8) The Rural Housing Service (RHS);

(9) The Rural Utilities Service (RUS) (but not for programs authorized by the Rural Electrification Act of 1936 or the Rural Telephone Bank Act, 7 U.S.C. 901 *et seq.*);

(10) A State, county, or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act (16 U.S.C. 590h (b)(5)); and

(11) Any predecessor or successor agency to the above-named agencies, and any other agency or office of the Department which the Secretary may designate.

Agency record means all the materials maintained by an agency related to an adverse decision which are submitted to the Division by an agency for consideration in connection with an appeal under this part, including all materials prepared or reviewed by the agency during its consideration and decision-making process, but shall not include records or information not related to the adverse decision at issue. All materials contained in the agency record submitted to the Division shall be deemed admitted as evidence for purposes of a hearing or a record review under § 11.8.

Agency representative means any person, whether or not an attorney, who is authorized to represent the agency in an administrative appeal under this part.

Appeal means a written request by a participant asking for review by the National Appeals Division of an adverse decision under this part.

Appellant means any participant who appeals an adverse decision in accordance with this part. Unless separately set forth in this part, the term ''appellant'' includes an authorized representative.

Authorized representative means any person, whether or not an attorney, who is authorized in writing by a participant, consistent with § 11.6(c), to act for the participant in an administrative appeal under this part. The authorized representative may act on behalf of the participant except when the provisions of this part require action by the participant or appellant personally.

Case record means all the materials maintained by the Secretary related to an adverse decision: The case record includes both the agency record and the hearing record.

Days means calendar days unless otherwise specified.

Department means the United States Department of Agriculture (USDA).

Director means the Director of the Division or a designee of the Director.

Division means the National Appeals Division established by this part.

Equitable relief means relief which is authorized under section 326 of the Food and Agriculture Act of 1962 (7 U.S.C. 1339a) and other laws administered by the agency.

Ex parte communication means an oral or written communication to any officer or employee of the Division with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports, or inquiries on Division procedure, in reference to any matter or proceeding connected with the appeal involved.

Hearing, except with respect to § 11.5, means a proceeding before the Division to afford a participant the opportunity to present testimony or documentary evidence or both in order to have a previous determination reversed and to show why an adverse determination was in error.

Hearing Officer means an individual employed by the Division who conducts the hearing and determines appeals of adverse decisions by any agency.

Hearing record means all documents, evidence, and other materials generated in relation to a hearing under $11.8.

Implement means the taking of action by an agency of the Department in order fully and promptly to effectuate a final determination of the Division.

Participant means any individual or entity who has applied for, or whose right to participate in or receive, a payment, loan, loan guarantee, or other benefit in accordance with any program of an agency to which the regulations in this part apply is affected by a decision of such agency. The term does not include persons whose claim(s) arise under:

(1) Programs subject to various proceedings provided for in 7 CFR part 1;

(2) Programs governed by Federal contracting laws and regulations (appealable under other rules and to other forums, including to the Department's Board of Contract Appeals under 7 CFR part 24);

(3) The Freedom of Information Act (appealable under 7 CFR part 1, subpart A);

(4) Suspension and debarment disputes, including, but not limited to, those falling within the scope of 7 CFR parts 1407 and 3017;

(5) Export programs administered by the Commodity Credit Corporation;

(6) Disputes between reinsured companies and the Federal Crop Insurance Corporation;

(7) Tenant grievances or appeals prosecutable under the provisions of 7 CFR part 1944, subpart L, under the multifamily housing program carried out by RHS;

(8) Personnel, equal employment opportunity, and other similar disputes with any agency or office of the Department which arise out of the employment relationship;

(9) The Federal Tort Claims Act, 28 U.S.C. 2671 *et seq.*, or the Military Personnel and Civilian Employees Claims Act of 1964, 31 U.S.C. 3721;

(10) Discrimination complaints prosecutable under the nondiscrimination regulations at 7 CFR parts 15, 15a, 15b, 15e, and 15f; or

(11) Section 361, *et seq.*, of the Agricultural Adjustment Act of 1938, as amended (7 U.S.C. 1361, *et seq.*) involving Tobacco Marketing Quota Review Committees.

Record review means an appeal considered by the Hearing Officer in which the Hearing Officer's determination is based on the agency record and other information submitted by the appellant and the agency, including information submitted by affidavit or declaration.

Secretary means the Secretary of Agriculture.

§ 11.2 General statement.

(a) This part sets forth procedures for proceedings before the National Appeals Division within the Department. The Division is an organization within the Department, subject to the general supervision of and policy direction by the Secretary, which is independent from all other agencies and offices of the Department, including Department officials at the state and local level. The Director of the Division reports directly to the Secretary of Agriculture. The authority of the Hearing Officers and the Director of the Division, and the administrative appeal procedures which must be followed by program participants who desire to appeal an adverse decision and by the agency which issued the adverse decision, are included in this part.

(b) Pursuant to section 212(e) of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Pub. L. 103–354 (the Act), 7 U.S.C. 6912(e), program participants shall seek review of an adverse decision before a Hearing Officer of the Division, and may seek further review by the Director, under the provisions of this part prior to seeking judicial review.

§ 11.3 Applicability.

(a) *Subject matter.* The regulations contained in this part are applicable to adverse decisions made by an agency, including, for example, those with respect to:

(1) Denial of participation in, or receipt of benefits under, any program of an agency;

(2) Compliance with program requirements;

(3) The making or amount of payments or other program benefits to a participant in any program of an agency; and

(4) A determination that a parcel of land is a wetland or highly erodible land.

(b) *Limitation.* The procedures contained in this part may not be used to seek review of statutes or USDA regulations issued under Federal Law.

§ 11.4 Inapplicability of other laws and regulations.

(a) Reserved.

(b) The Federal Rules of Evidence, 28 U.S.C. App., shall not apply to proceedings under this part.

§11.5 Informal review of adverse decisions.

(a) *Required informal review of FSA adverse decisions.* Except with respect to farm credit programs, a participant must seek an informal review of an adverse decision issued at the field service office level by an officer or employee of FSA, or by any employee of a county or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act, 16 U.S.C. 590h(b)(5), before NAD will accept an appeal of a FSA adverse decision. Such informal review shall be done by the county or area committee with responsibility for the adverse decision at issue. The procedures for requesting such an informal review before FSA are found in 7 CFR part 780. After receiving a decision upon review by a county or area committee, a participant may seek further informal review by the State FSA committee or may appeal directly to NAD under §11.6(b).

(b) *Optional informal review.* With respect to adverse decisions issued at the State office level of FSA and adverse decisions of all other agencies, a participant may request an agency informal review of an adverse decision of that agency prior to appealing to NAD. Procedures for requesting such an informal review are found at 7 CFR part 780 (FSA), 7 CFR part 614 (NRCS), 7 CFR part 1900, subpart B (RUS), 7 CFR part 1900, subpart B (RBS), and 7 CFR part 1900, subpart B (RHS).

(c) *Mediation.* A participant also shall have the right to utilize any available alternative dispute resolution (ADR) or mediation program, including any mediation program available under title V of the Agricultural Credit Act of 1987, 7 U.S.C. 5101 *et seq.*, in order to attempt to seek resolution of an adverse decision of an agency prior to a NAD hearing. If a participant:

(1) Requests mediation or ADR prior to filing an appeal with NAD, the participant stops the running of the 30-day period during which a participant may appeal to NAD under §11.6(b)(1), and will have the balance of days remaining in that period to appeal to NAD once mediation or ADR has concluded.

(2) Requests mediation or ADR after having filed an appeal to NAD under §11.6(b), but before the hearing, the participant will be deemed to have waived his right to have a hearing within 45 days under §11.8(c)(1) but shall have a right to have a hearing within 45 days after conclusion of mediation or ADR.

§11.6 Director review of agency determination of appealability and right of participants to Division hearing.

(a) *Director review of agency determination of appealability.* (1) Not later than 30 days after the date on which a participant receives a determination from an agency that an agency decision is not appealable, the participant must submit a written request personally signed by the participant to the Director to review the determination in order to obtain such review by the Director.

(2) The Director shall determined whether the decision is adverse to the individual participant and thus appealable or is a matter of general applicability and thus not subject to appeal, and will issue a final determination notice that upholds or reverses the determination of the agency. This final determination is not appealable. If the Director reverses the determination of the agency, the Director will notify the participant and the agency of that decision and inform the participant of his or her right to proceed with an appeal.

(3) The Director may delegate his or her authority to conduct a review under this paragraph to any subordinate official of the Division other than a Hearing Officer. In any case in which such review is conducted by such a subordinate official, the subordinate official's determination shall be considered to be the determination of the Director and shall be final and not appealable.

(b) *Appeals of adverse decisions.* (1) To obtain a hearing under §11.8, a participant personally must request such hearing not later than 30 days after the date on which the participant first received notice of the adverse decision or after the date on which the participant receives notice of the Director's determination that a decision is appealable. In the case of the failure of an agency to act on the request or right of a recipient, a participant personally must

request such hearing not later than 30 days after the participant knew or reasonably should have known that the agency had not acted within the timeframes specified by agency program regulations, or, where such regulations specify no timeframes, not later than 30 days after the participant reasonably should have known of the agency's failure to act.

(2) A request for a hearing shall be in writing and personally signed by the participant, and shall include a copy of the adverse decision to be reviewed, if available, along with a brief statement of the participant's reasons for believing that the decision, or the agency's failure to act, was wrong. The participant also shall send a copy of the request for a hearing to the agency, and may send a copy of the adverse decision to be reviewed to the agency, but failure to do either will not constitute grounds for dismissal of the appeal. Instead of a hearing, the participant may request a record review.

(c) If a participant is represented by an authorized representative, the authorized representative must file a declaration with NAD, executed in accordance with 28 U.S.C. 1746, stating that the participant has duly authorized the declarant in writing to represent the participant for purposes of a specified adverse decision or decisions, and attach a copy of the written authorization to the declaration.

§ 11.7 Ex parte communications.

(a)(1) At no time between the filing of an appeal and the issuance of a final determination under this part shall any officer or employee of the Division engage in *ex parte* communications regarding the merits of the appeal with any person having any interest in the appeal pending before the Division, including any person in an advocacy or investigative capacity. This prohibition does not apply to:

(i) Discussions of procedural matters related to an appeal; or

(ii) Discussions of the merits of the appeal where all parties to the appeal have been given notice and an opportunity to participate.

(2) In the case of a communication described in paragraph (a)(1)(ii) of this section, a memorandum of any such discussion shall be included in the hearing record.

(b) No interested person shall make or knowingly cause to be made to any officer or employee of the Division an *ex parte* communication relevant to the merits of the appeal.

(c) If any officer or employee of the Division receives an *ex parte* communication in violation of this section, the one who receives the communication shall place in the hearing record:

(1) All such written communications;

(2) Memoranda stating the substance of all such oral communications; and

(3) All written responses to such communications, and memoranda stating the substance of any oral responses thereto.

(d) Upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this section the Hearing Officer or Director may, to the extent consistent with the interests of justice and the policy of the underlying program, require the party to show cause why such party's claim or interest in the appeal should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation.

§ 11.8 Division hearings.

(a) *General rules.* (1) The Director, the Hearing Officer, and the appellant shall have access to the agency record of any adverse decision appealed to the Division for a hearing. Upon request by the appellant, the agency shall provide the appellant a copy of the agency record.

(2) The Director and Hearing Officer shall have the authority to administer oaths and affirmations, and to require, by subpoena, the attendance of witnesses and the production of evidence. A Hearing Officer shall obtain the concurrence of the Director prior to issuing a subpoena.

(i) A subpoena requiring the production of evidence may be requested and issued at any time while the case is pending before the Division.

(ii) An appellant or an agency, acting through any appropriate official, may request the issuance of a subpoena requiring the attendance of a witness by submitting such a request in writing at least 14 days before the scheduled date of a hearing. The Director or Hearing

Officer shall issue a subpoena at least 7 days prior to the scheduled date of a hearing.

(iii) A subpoena shall be issued only if the Director or a Hearing Officer determined that:

(A) For a subpoena of documents, the appellant or the agency has established that production of documentary evidence is necessary and is reasonably calculated to lead to information which would affect the final determination or is necessary to fully present the case before the Division; or

(B) For a subpoena of a witness, the appellant or the agency has established that either a representative of the Department or a private individual possesses information that is pertinent and necessary for disclosure of all relevant facts which could impact the final determination, that the information cannot be obtained except through testimony of the person, and that the testimony cannot be obtained absent issuance of a subpoena.

(iv) The party requesting issuance of a subpoena shall arrange for service. Service of a subpoena upon a person named therein may be made by registered or certified mail, or in person. Personal service shall be made by personal delivery of a copy of the subpoena to the person named therein by any person who is not a party and who is not less than 18 years of age. Proof of service shall be made by filing with the Hearing Officer or Director who issued the subpoena a statement of the date and manner of service and of the names of the persons served, certified by the person who made the service in person or by return receipts for certified or registered mail.

(v) A party who requests that a subpoena be issued shall be responsible for the payment of any reasonable travel and subsistence costs incurred by the witness in connection with his or her appearance and any fees of a person who serves the subpoena in person. The Department shall pay the costs associated with the appearance of a Department employee whose role as a witness arises out of his or her performance of official duties, regardless of which party requested the subpoena. The failure to make payment of such charges on demand may be deemed by the Hearing Officer or Director as sufficient ground for striking the testimony of the witness and the evidence the witness has produced.

(vi) If a person refuses to obey a subpoena, the Director, acting through the Office of the General Counsel of the Department and the Department of Justice, may apply to the United States District Court in the jurisdiction where that person resides to have the subpoena enforced as provided in the Federal Rules of Civil Procedure (28 U.S.C. App.).

(3) Testimony required by subpoena pursuant to paragraph (a)(2) of this section may, at the discretion of the Director or a Hearing Officer, be presented at the hearing either in person or telephonically.

(b) *Hearing procedures applicable to both record review and hearings.* (1) Upon the filing of an appeal under this part of an adverse decision by any agency, the agency promptly shall provide the Division with a copy of the agency record. If requested by the applicant prior to the hearing, a copy of such agency record shall be provided to the appellant by the agency within 10 days of receipt of the request by the agency.

(2) The Director shall assign the appeal to a Hearing Officer and shall notify the appellant and agency of such assignment. The notice also shall advise the appellant and the agency of the documents required to be submitted under paragraph (c)(2) of this section, and notify the appellant of the option of having a hearing by telephone.

(3) The Hearing Officer will receive evidence into the hearing record without regard to whether the evidence was known to the agency officer, employee, or committee making the adverse decision at the time the adverse decision was made.

(c) *Procedures applicable only to hearings.* (1) Upon a timely request for a hearing under § 11.6(b), an appellant has the right to have a hearing by the Division on any adverse decision within 45 days after the date of receipt of the request for the hearing by the Division.

(2) The Hearing Officer shall set a reasonable deadline for submission of the following documents:

(i) By the appellant;

(A) A short statement of why the decision is wrong;

(B) A copy of any document not in the agency record that the appellant anticipates introducing at the hearing; and

(C) A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

(ii) By the agency:

(A) A copy of the adverse decision challenged by the appellant;

(B) A written explanation of the agency's position, including the regulatory or statutory basis therefor;

(C) A copy of any document not in the agency record that the agency anticipates introducing at the hearing; and

(D) A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

(3) Not less than 14 days prior to the hearing, the Division must provide the appellant, the authorized representative, and the agency a notice of hearing specifying the date, time, and place of the hearing. The hearing will be held in the State of residence of the appellant, as determined by the Hearing Officer, or at a location that is otherwise convenient to the appellant, the agency, and the Division. The notice also shall notify all parties of the right to obtain an official record of the hearing.

(4) Pre-hearing conference. Whenever appropriate, the Hearing Officer shall hold a pre-hearing conference in order to attempt to resolve the dispute or to narrow the issues involved. Such pre-hearing conference shall be held by telephone unless the Hearing Officer and all parties agree to hold such conference in person.

(5) Conduct of the hearing. (i) A hearing before a Hearing Officer will be in person unless the appellant agrees to a hearing by telephone.

(ii) The hearing will be conducted by the Hearing Officer in the manner determined by the Division most likely to obtain the facts relevant to the matter or matters at issue. The Hearing Officer will allow the presentation of evidence at the hearing by any party without regard to whether the evidence was known to the officer, employee, or committee of the agency making the adverse decision at the time the adverse decision was made. The Hearing Officer may confine the presentation of facts and evidence to pertinent matters and exclude irrelevant, immaterial, or unduly repetitious evidence, information, or questions. Any party shall have the opportunity to present oral and documentary evidence, oral testimony of witnesses, and arguments in support of the party's position; controvert evidence relied on by any other party; and question all witnesses. When appropriate, agency witnesses requested by the appellant will be made available at the hearing. Any evidence may be received by the Hearing Officer without regard to whether that evidence could be admitted in judicial proceedings.

(iii) An official record shall be made of the proceedings of every hearing. This record will be made by an official tape recording by the Division. In addition, either party may request that a verbatim transcript be made of the hearing proceedings and that such transcript shall be made the official record of the hearing. The party requesting a verbatim transcript shall pay for the transcription service, shall provide a certified copy of the transcript to the Hearing Officer free of charge, and shall allow any other party desiring to purchase a copy of the transcript to order it from the transcription service.

(6) Absence of parties. (i) If at the time scheduled for the hearing either the appellant or the agency representative is absent, and no appearance is made on behalf of such absent party, or no arrangements have been made for rescheduling the hearing, the Hearing Officer has the option to cancel the hearing unless the absent party has good cause for the failure to appear. If the Hearing Officer elects to cancel the hearing, the Hearing Officer may:

(A) Treat the appeal as a record review and issue a determination based on the agency record as submitted by the agency and the hearing record developed prior to the hearing date;

(B) Accept evidence into the hearing record submitted by any party present at the hearing (subject to paragraph (c)(6)(ii) of this section), and then issue a determination; or

(C) Dismiss the appeal.

(ii) When a hearing is cancelled due to the absence of a party, the Hearing Officer will add to the hearing record any additional evidence submitted by any party present, provide a copy of such evidence to the absent party or parties, and allow the absent party or parties 10 days to provide a response to such additional evidence for inclusion in the hearing record

(iii) Where an absent party has demonstrated good cause for the failure to appear, the Hearing Officer shall reschedule the hearing unless all parties agree to proceed without a hearing.

(7) Post-hearing procedure. The Hearing Officer will leave the hearing record open after the hearing for 10 days, or for such other period of time as the Hearing Officer shall establish, to allow the submission of information by the appellant or the agency, to the extent necessary to respond to new facts, information, arguments, or evidence presented or raised at the hearing. Any such new information will be added by the Hearing Office to the hearing record and sent to the other party or parties by the submitter of the information. The Hearing Officer, in his or her discretion, may permit the other party or parties to respond to this post-hearing submission.

(d) *Interlocutory review*. Interlocutory review by the Director of rulings of a Hearing Officer are not permitted under the procedures of this part.

(e) *Burden of proof.* The appellant has the burden of proving that the adverse decision of the agency was erroneous by a preponderance of the evidence.

(f) *Timing of issuance of determination*. The Hearing Officer will issue a notice of the determination on the appeal to the named appellant, the authorized representative, and the agency not later than 30 days after a hearing or the closing date of the hearing record in cases in which the Hearing Officer receives additional evidence from the agency or appellant after a hearing. In the case of a record review, the Hearing Officer will issue a notice of determination within 45 days of receipt of the appellant's request for a record review. Upon the Hearing Officer's request, the Director may establish an earlier or later deadline. A notice of determination shall be accompanied by a copy of the procedures for filing a request for Director review under §11.9. If the determination is not appealed to the Director for review under §11.9, the notice provided by the Hearing Officer shall be considered to be a notice of a final determination under this part.

§11.9 Director review of determinations of Hearing Officers.

(a) *Requests for Director review*. (1) Not later than 30 days after the date on which an appellant receives the determination of a Hearing Officer under §11.8, the appellant must submit a written request, signed personally by the named appellant, to the Director to review the determination in order to be entitled to such review by the Director. Such request shall include specific reasons why the appellant believes the determination is wrong.

(2) Not later than 15 business days after the date on which an agency receives the determination of a Hearing Officer under §11.8, the head of the agency may make a written request that the Director review the determination. Such request shall include specific reasons why the agency believes the determination is wrong, including citations of statutes or regulations that the agency believes the determination violates. Any such request may be made by the head of an agency only, or by a person acting in such capacity, but not by any subordinate officer of such agency.

(3) A copy of a request for Director review submitted under this paragraph shall be provided simultaneously by the submitter to each party to the appeal.

(b) *Notification of parties.* The Director promptly shall notify all parties of receipt of a request for review.

(c) *Responses to request for Director review*. Other parties to an appeal may submit written responses to a request for Director review within 5 business days from the date of receipt of a copy of the request for review.

(d) *Determination of Director.* (1) The Director will conduct a review of the determination of the Hearing Officer using the agency record, the hearing record, the request for review, any responses submitted under paragraph (c)

of this section, and such other arguments or information as may be accepted by the Director, in order to determine whether the decision of the Hearing Officer is supported by substantial evidence. Based on such review, the Director will issue a final determination notice that upholds, reverses, or modifies the determination of the Hearing Officer. The Director's determination upon review of a Hearing Officer's decision shall be considered to be the final determination under this part and shall not be appealable. However, if the Director determines that the hearing record is inadequate or that new evidence has been submitted, the Director may remand all or a portion of the determination to the Hearing Officer for further proceedings to complete the hearing record or, at the option of the Director, to hold a new hearing.

(2) The Director will complete the review and either issue a final determination or remand the determination not later than—

(i) 10 business days after receipt of the request for review, in the case of a request by the head of an agency; or

(ii) 30 business days after receipt of the request for review, in the case of a request by an appellant.

(3) In any case or any category of cases, the Director may delegate his or her authority to conduct a review under this section to any Deputy or Assistant Directors of the Division. In any case in which such review is conducted by a Deputy or Assistant Director under authority delegated by the Director, the Deputy or Assistant Director's determination shall be considered to be the determination of the Director under this part and shall be final and not appealable.

(e) *Equitable relief.* In reaching a decision on an appeal, the Director shall have the authority to grant equitable relief under this part in the same manner and to the same extent as such authority is provided an agency under applicable laws and regulations.

§ 11.10 Basis for determinations.

(a) In making a determination, the Hearing Officers and the Director are not bound by previous findings of facts on which the agency's adverse decision was based.

(b) In making a determination on the appeal, Hearing Officers and the Director shall ensure that the decision is consistent with the laws and regulations of the agency, and with the generally applicable interpretations of such laws and regulations.

(c) All determinations of the Hearing Officers and the Director must be based on information from the case record, laws applicable to the matter at issue, and applicable regulations published in the FEDERAL REGISTER and in effect on the date of the adverse decision or the date on which the acts that gave rise to the adverse decision occurred, whichever date is appropriate under the applicable agency program laws and regulations.

§ 11.11 Reconsideration of Director determinations.

(a) Reconsideration of a determination of the Director may be requested by the appellant or the agency within 10 days of receipt of the determination. The Director will not consider any request for reconsideration that does not contain a detailed statement of a material error of fact made in the determination, or a detailed explanation of how the determination is contrary to statute or regulation, which would justify reversal or modification of the determination.

(b) The Director shall issue a notice to all parties as to whether a request for reconsideration meets the criteria in paragraph (a) of this section. If the request for reconsideration meets such criteria, the Director shall include a copy of the request for reconsideration in the notice to the non-requesting parties to the appeal. The non-requesting parties shall have 5 days from receipt of such notice from the Director to file a response to the request for reconsideration with the Director.

(c) The Director shall issue a decision on the request for reconsideration within 5 days of receipt of responses from the non-requesting parties. If the Director's decision upon reconsideration reverses or modifies the final determination of the Director rendered under § 11.9(d), the Director's decision on reconsideration will become the

final determination of the Director under §11.9(d) for purposes of this part.

§11.12 Effective date and implementation of final determinations of the Division.

(a) On the return of a case to an agency pursuant to the final determination of the Division, the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.

(b) A final determination will be effective as of the date of filing of an application, the date of the transaction or event in question, or the date of the original adverse decision, whichever is applicable under the applicable agency program statutes or regulations.

§11.13 Judicial review.

(a) A final determination of the Division shall be reviewable and enforceable by any United States District Court of competent jurisdiction in accordance with chapter 7 of title 5, United States Code.

(b) An appellant may not seek judicial review of any agency adverse decision appealable under this part without receiving a final determination from the Division pursuant to the procedures of this part.

§11.14 Filing of appeals and computation of time.

(a) An appeal, a request for Director Review, or any other document will be considered ''filed'' when delivered in writing to the Division, when postmarked, or when a complete facsimile copy is received by the Division.

(b) Whenever the final date for any requirement of this part falls on a Saturday, Sunday, Federal holiday, or other day on which the Division is not open for the transaction of business during normal working hours, the time for filing will be extended to the close of business on the next working day.

(c) The time for filing an appeal, a request for Director review, or any other document expires at 5:00 p.m. local time at the office of the Division to which the filing is submitted on the last day on which such filing may be made.

§11.15 Participation of third parties and interested parties in Division proceedings.

In two situations, parties other than the appellant or the agency may be interested in participating in Division proceedings. In the first situation, a Division proceeding may in fact result in the adjudication of the rights of a third party, e.g., an appeal of a tenant involving a payment shared with a landlord, an appeal by one recipient of a portion of a payment shared by multiple parties, an appeal by one heir of an estate. In the second situation, a party may desire to receive notice of and perhaps participate in an appeal because of the derivative impact the appeal determination will have on that party, e.g., guaranteed lenders and reinsurance companies. The provisions in this section set forth rules for the participation of such third and interested parties.

(a) *Third parties.* When an appeal is filed, the Division shall notify any potential third party whose rights may be adjudicated of its right to participate as an appellant in the appeal. This includes the right to seek Director review of the Hearing Officer determination. Such third parties may be identified by the Division itself, by an agency, or by the original appellant. The Division shall issue one notice to the third party of its right to participate, and if such party declines to participate, the Division determination will be binding as to that third party as if it had participated. For purposes of this part, a third party includes any party for which a determination of the Division could lead to an agency action on implementation that would be adverse to the party thus giving such party a right to a Division appeal.

(b) *Interested parties.* With respect to a participant who is a borrower under a guaranteed loan or an insured under a crop insurance program, the respective guaranteed lender or reinsurance company having an interest in a participant's appeal under this part may participate in the appeal as an interested party, but such participation does not confer the status of an appellant upon the guaranteed lender or reinsurance

company such that it may request Director review of a final determination of the Division.

Subpart B—Organization And Functions

AUTHORITY: 5 U.S.C. 301 and 552; 7 CFR part 2.

SOURCE: 63 FR 44773, Aug. 21, 1998, unless otherwise noted.

§ 11.20 General statement.

This subpart provides guidance for the general public as to the organization and functions of NAD.

§ 11.21 Organization.

NAD was established on October 13, 1994. Delegation of authority to the Director, NAD, appears at §2.34 of this title. The organization is comprised of three regional offices: Eastern Regional Office, Indianapolis, Indiana; Southern Regional Office, Memphis, Tennessee; and Western Regional Office, Lakewood, Colorado; and the headquarters staff located in Alexandria, Virginia. NAD is headed by a Director. NAD is assigned responsibility for certain administrative appeals as set forth in subpart A of this part.

§ 11.22 Functions.

(a) *Director.* Provides executive direction for NAD. The Director is responsible for developing and implementing nationwide plans, policies, and procedures for the timely and orderly hearing and disposition of appeals filed by individuals or entities in accordance with subpart A of this part. The Director will respond to all FOIA requests concerning appeal decisions and case records maintained by NAD.

(b) *Deputy Director for Hearings and Administration.* Responsible for all administrative functions of NAD, including budget, correspondence, personnel, travel, equipment, and regulation review and development.

(c) *Deputy Director for Planning, Training, and Quality Control.* Responsible for NAD strategic planning, including the organization's compliance with the Government Performance and Results Act, Pub. L. 103–62, employee training, and the establishment and maintenance of a quality assurance program.

(d) *Assistant Directors for Regions.* Responsible for oversight of the adjudication process for cases filed in the NAD regional offices. Assistant Directors ensure statutory and administrative time frames are met, and oversee the administrative functions, training, and supervision of the support staff located in the regional offices and the large dispersed staff of professional hearing officers located throughout the regions. The three regional offices serve as the custodian for all NAD determinations and case records.

Subpart C—Availability of Information to the Public

AUTHORITY: 5 U.S.C. 301 and 552; 7 CFR 1.1–1.16.

SOURCE: 63 FR 44774, Aug. 21, 1998, unless otherwise noted.

§ 11.30 General statement.

This subpart implements the regulations of the Secretary of Agriculture at 7 CFR 1.1 through 1.16 concerning FOIA (5 U.S.C. 552). The Secretary's regulations, as implemented by the regulations in this part, govern the availability of the records of NAD to the public.

§ 11.31 Public inspection and copying.

Section 1.5 of this title requires that certain materials be made available by each USDA agency for public inspection and copying in accordance with 5 U.S.C. 522(a)(2). Members of the public wishing to gain access to these NAD records should write to the appropriate address shown in Appendix A of this subpart.

§ 11.32 Initial requests for records.

(a) Requests for NAD records should be in writing and addressed to the NAD official having custody of the records desired as indicated in §11.22(d). Addresses are found in Appendix A of this subpart. In his or her petition, the requester may ask for a fee waiver if there is likely to be a charge for the requested information. The criteria for waiver of fees are found in section 6 of appendix A, subpart A of part 1 of this

title. All requests for records shall be deemed to have been made pursuant to FOIA, regardless of whether FOIA is specifically mentioned. To facilitate processing of a request, the phrase ''FOIA REQUEST'' should be placed in capital letters on the front of the envelope.

(b) A request must reasonably describe records to enable NAD personnel to locate them with reasonable effort. Where possible, a requester should supply specific information, such as dates, titles, appellant name or appeal number, that may help identify the records. If the request relates to a matter in pending litigation, the court and its location should be identified.

(c) If NAD determines that a request does not reasonably describe the records, it shall inform the requester of this fact and extend the requester an opportunity to clarify the request or to confer promptly with knowledgeable NAD personnel to attempt to identify the records he or she is seeking. The ''date of receipt'' in such instances, for purposes of §1.12(a) of this title, shall be the date of receipt of the amended or clarified request.

(d) Nothing in this subpart shall be interpreted to preclude NAD from honoring an oral request for information, but if the requester is dissatisfied with the response, the NAD official involved shall advise the requester to submit a written request in accordance with paragraph (a) of this section. The ''date of receipt'' of such a request for purposes of §1.12(a) of this title shall be the date of receipt of the written request. For recordkeeping purposes, the NAD official responding to an oral request for information may ask the requester to also submit his or her request in writing.

(e) If a request for records or a fee waiver under this subpart is denied, the person making the request shall have the right to appeal the denial. Requesters also may appeal NAD decisions regarding a requester's status for purposes of fee levels under section 5 of Appendix A, subpart A of part 1 of this title. All appeals must be in writing and addressed to the official designated in §11.33. To facilitate processing of an appeal, the phrase ''FOIA APPEAL'' should be placed in capital letters on the front of the envelope.

(f) NAD shall develop and maintain a record of all written and oral FOIA requests and FOIA appeals received by NAD, which shall include, in addition to any other information, the name of the requester, brief summary of the information requested, an indication of whether the request or appeal was denied or partially denied, the FOIA exemption(s) cited as the basis for any denials, and the amount of fees associated with the request or appeal.

§11.33 Appeals.

Any person whose initial FOIA request is denied in whole or in part may appeal that denial to the Director, National Appeals Division, U.S. Department of Agriculture, 3101 Park Center Drive, Suite 1113, Alexandria, Virginia 22302. The Director will make the final determination on the appeal.

APPENDIX A TO SUBPART C OF PART 11—LIST OF ADDRESSES

This list provides the titles and mailing addresses of officials who have custody of NAD records. This list also identifies the normal working hours, Monday through Friday, excluding holidays, during which public inspection and copying of certain kinds of records is permitted.

Director, National Appeals Division, U.S. Department of Agriculture, 3101 Park Center Drive, Suite 1113, Alexandria, Virginia 22302, Hours: 8 a.m.–5 p.m.

Regional Assistant Director, Eastern Region, National Appeals Division, U.S. Department of Agriculture, 3500 DePauw Boulevard, Suite 2052, Indianapolis, Indiana 46268, Hours: 8 a.m.–5 p.m.

Regional Assistant Director, Southern Region, National Appeals Division, U.S. Department of Agriculture, 7777 Walnut Grove Road, LLB–1, Memphis, Tennessee 38120, Hours: 8 a.m.–5 p.m.

Regional Assistant Director, Western Region, National Appeals Division, U.S. Department of Agriculture, 755 Parfet Street, Suite 494, Lakewood, Colorado 80215–5506, Hours: 8 a.m.–5 p.m.

PART 12—HIGHLY ERODIBLE LAND AND WETLAND CONSERVATION

Subpart A—General Provisions

Sec.

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APPENDIX 3

FORMS REFERENCED IN THIS HANDBOOK

Below is a list of forms that are mentioned in the text of this handbook. Since the Rural Development forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (http://rdinit.usda.gov/regs) for their own reference.

Form AD 343, Cancellation of Administrative Offset
Form AD 1047 Certification Regarding Debarment
Form ASTM Standard E-1528 (TSQ), Transaction Screen Questionnaire
Form FEMA 81-93, Standard Flood Hazard Determination
Form HUD 935.2, Affirmative Fair Housing Marketing Plan
Form HUD 2530, Previous Participation Certification
Form HUD 9832, Management Entity Profile
Form RD 140-4, Transmittal of Documents
Form RD 400-1, Equal Opportunity Agreement
Form RD 400-4, Assurance Agreement
Form RD 402-2, Statement of Deposits and Withdrawals
Form RD 440-34, Option to Purchase Real Estate Property
Form RD 1910-11, Applicant Certification Federal Collection Policies for Consumer or Commercial Debts
Form RD 1924-13, Estimate and Certificate of Actual Cost
Form RD 1944-37, Previous Participation Certification
Form RD 1955-40, Notice of Real Property for Sale
Form RD 1955-45, Standard Sales Contract, Sale of Real Property of the United States
Form RD 1955-46, Invitation, Bid, and Acceptance, Sale of Real Property of the United States
Form RD 1955-47, Bill of Sale 'A'
Form RD 1955-49, Quitclaim Deed
Form RD 1955-62, Request for Contract Services for Custodial/Inventory Property or Program Services
Form RD 1962-20, Notice of Judgment
Form RD 3560-1, Application for Partial Release, Subordination, or Consent
Form RD 3560-7, Multiple Family Housing Budget/Utility Allowance
Form RD 3560-8, Tenant Certification
Form RD 3560-9, Interest Credit and Rental Assistance Agreement
Form RD 3560-10, Borrower Balance Sheet
Form RD 3560-15, Reamortization Request
Form RD 3560-16, Reamortization Agreement
Form RD 3560-17, MFH Note Consolidation
Form RD 3560-17A, MFH Consolidation of Projects/Loan Agreements/Resolutions
Form RD 3560-19, MFH Advice of Mortgaged Real Estate Sold
Form RD 3560-20, Multi-Family Housing Transfer and Assumption Review and Recommendation
Form RD 3560-21, Assumption Agreement

Form RD 3560-22, Offer to Convey Security
Form RD 3560-27, Rental Assistance Agreement
Form RD 3560-28, MFH Exception to Late Fees
Form RD 3560-29, Notice of Payment Due Report
Form RD 3560-29A, Multiple Family Housing Statement of Payment Due
Form RD 3560-30, Certification of No Identity of Interest (IOI)
Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate
Form RD 3560-33, Loan Agreement
Form RD 3560-33A, Consolidated Loan Agreement
Form RD 3560-34, Loan Agreement
Form RD 3560-34A, Consolidated RRH Loan Agreement
Form RD 3560-35, Loan Resolution
Form RD 3560-35A, Consolidated Loan Resolution
Form RD 3560-50, Conversion Agreement
Form RD 3560-51, Obligation – Fund Analysis
Form RD 3560-52, Promissory Note
Form RD 3560-55, MFH Transfer of RA
Form RD 3560-56, Report on Real Estate Problem Case
Form RD 3560-57, Application for Settlement of Indebtedness
Form RD 3560-58, Satisfaction
Form RD 3560-64, Online Payment Certification Monitoring Log
Form SF 424, Application for Federal Assistance
SF 424 C, Budget Information – Construction Programs
SF 424 D, Assurances – Construction Programs
SF - LLL, Disclosure of Lobbying Activities
IRS Form 990, Return of Organization Exempt from Income Tax

APPENDIX 4

HANDBOOK LETTERS REFERENCED IN THIS HANDBOOK

Handbook Letter 301 (3560), Servicing Letter #1
Handbook Letter 302 (3560), Servicing Letter #2
Handbook Letter 303 (3560), Servicing Letter #3

Handbook Letter 301 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #1

ROUTINE NOTICE OF SERVICING RESULTS/CONCERNS

[*insert date*]

Dear [*insert name of borrower*]:

We are writing to inform you of the results of a recent review of certain selected aspects of your operations. A copy of the results of our review is attached [*Attach copy of supervisory visit report, physical inspection report, compliance review, reserve records, notice of payment due, etc.*].

Please review the attached material and note the areas of concern listed. [*if necessary, insert* "We want to especially bring to your attention the following items:"]

We are asking that you contact this office within 15 days of the date of this letter to inform us of the corrective actions you have taken, or plan to take, to correct the concerns listed. Our office address and telephone number are: [*insert address and telephone number*]

Sincerely,

_____

[*Signature and title of Official*]

Attachment

Handbook Letter 302 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #2

NOTIFICATION OF SERIOUS SERVICING CONCERNS

[*insert date*]

Dear [*insert name of borrower*]:

We are writing to inform you that certain aspects of your project operations are of serious concern to the Agency.

A brief description of the items of concern which warrant attention is [*insert either*: "provided below:" *or* "attached."]

We would like to arrange a meeting to discuss these concerns. [*insert either*: "Please contact our office to confirm if you can make the tentatively scheduled meeting at the following time, date, and location:" *or* "Please contact our office within 15 days of the date of this letter to make the necessary arrangements"]. Our address and telephone number are [*insert address and telephone number*].

Please be prepared to discuss the matters of concern identified. [*insert*: "In particular, you may want to bring the following information to the meeting:"]

We look forward to hearing from you.

Sincerely,

_____

[*Signature and title of Official*]

Attachment

Handbook Letter 303 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #3

NOTIFICATION OF INTENT TO PURSUE MORE FORCEFUL SERVICING ACTIONS

[*insert date*]

Dear [*insert name of borrower*]:

We regret that earlier attempts to resolve [*state the problems*] have not been successful. We are writing to inform you that Rural Development intends to take further action unless alternative arrangements are promptly made with this office. If you have not contacted us within 15 days, we intend to pursue the [*insert either*: "following actions:" *or* "attached actions."]

[*List actions, e.g., Forward a problem case report to the State Director, recommend an investigation by the Office of the Inspector General, demand a change in project management, place a recoverable cost charge on the account, forward a recommendation to the State Director to issue a Notice of Acceleration, etc.*]

We are hopeful we can avoid the necessity of taking the steps outlined above. Unfortunately, we will be forced to do so unless we hear from you within 15 days from the date of this letter.

Please contact our office immediately if you wish to avoid the actions described above.

Sincerely,

_____
[*Signature and title of Official*]

Attachment